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(a) "Non-Disability" policies [Death Benefits only]; and also all

(b) "Disability" policies [Death Benefits *combined* with Disability Benefits].

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2. For 1934 Oregon Mutual's $3,932,305.74 Reserve for "Disability" policies [including the disputed $250,861.09 Reserve for the Disability Benefits] was the *technical insurance reserve*, mathematically calculated as the then measure of its liability for the performance of only future, unaccrued and contingent policy obligations [Death and Disability Benefits] 38

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OPINIONS BELOW: **No. 2**; *New World Life* v. *U. S.*, 26 F. Supp. 444; R32-60;

No. 564; *Commissioner* v. *Oregon Mutual Life*, 112 F. (2d) 314; R193; 39 B. T. A. 1239; (R43-49).

JURISDICTIONAL AUTHORITY: **No. 2**; Section 3(b) of Act of February 13, 1925, as amended May 22, 1939 [53 Stat. c. 140, p. 752].

Certiorari granted May 20, 1940 (R40); . . . U. S. . . .

No. 564; Judicial Code § 240(a) as amended by Act of February 13, 1925.

Certiorari granted November 12, 1940 (R192).

STATUTES INVOLVED: **No. 2**; §§ 201(a), 203(a)(2), Revenue Act of 1928 c. 852, 45 Stat. 791 at pp. 842, 843; and Revenue Act of 1932 c. 209, 47 Stat. 169 at pp. 223, 224;

No. 564; §§ 201(a), 203(a)(2), Revenue Act of 1932 c. 209, 47 Stat. 169, 223-4; Revenue Act of 1934 c. 277; 48 Stat. 680, 731-2.

DATE OF JUDGMENT, ETC.: **No. 2**; March 6, 1939 (R60).

No. 564; June 12, 1939 (R50).

NATURE OF THE CASE, RULING, ETC.: **No. 2**; *New World* case; Commissioner of Internal Revenue determined certain deficiencies in income tax for 1929-1932, against New World Life Insurance Company.

New World Life paid the deficiency taxes; and then sued the United States in the Court of Claims to recover certain parts of the deficiency taxes so paid (R1-16).

The Court of Claims held (1) that New World Life was not entitled to recover anything (R32, 60); and (2) that, while the United States was not seeking any affirmative judgment against the New World Life [because barred by the statute of limitations, R47], nevertheless, from its 1929-1932 income, New World Life had erroneously deducted 4% [3¾% for 1932] of its Active Life Reserves, and of its Disabled Life Reserves, held on account of its "contracts of *combined* life, health and accident insurance" [§§ 201(a), 203(a)(2) Revenue Acts 1928 and 1932] (R47-60).

This Court (1) denied certiorari on November 22, 1939 ... U. S. ...; (2) on December 18, 1939, granted until March 15, 1940 to file petition for rehearing; (3) on March 11, 1940, extended until May 1, 1940 time for filing petition for rehearing; (4) on May 20, 1940, granted rehearing; vacated denial of certiorari; and granted certiorari limited to the second question presented in the petition for certiorari.

No. 564: *Oregon Mutual* case; Commissioner of Internal Revenue determined certain deficiencies in income tax for 1933-34 against Oregon Mutual Life Insurance Company (R7-37).

Oregon Mutual petitioned the B. T. A. for a redetermination of $2,491.41 aggregate proposed income-tax-deficiencies for 1933 and 1934 (Id).

The B. T. A. decided (R43-51) and the C. C. A. (9th) *affirmed*, that Oregon Mutual was entitled to deduct $18,119.37 from its gross income, as 3¾% of the "mean of the reserve funds, required by law" for the fulfillment of its future, unaccrued, and contingent obligations [dependent upon life and disability contingencies] to pay Disability Benefits under its "contracts of *combined* life, health, and accident insurance" as allowed by §§ 201(a), 203(a)(2) of the Revenue Acts of 1932 and 1934.

Commissioner of Internal Revenue petitioned for *certiorari*, which this Court granted.

Supreme Court of the United States

October Term, 1940

NEW WORLD LIFE INSURANCE COMPANY, *Petitioner,* *vs.* **No. 2** UNITED STATES.	*On Writ of Certiorari to the Court of Claims*
COMMISSIONER OF INTERNAL REVENUE, *vs.* **No. 564** OREGON MUTUAL LIFE INSURANCE COMPANY.	*On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit*

BRIEF FOR THE LIFE INSURANCE COMPANIES.

The Revenue Acts of 1932 and 1934 permitted life insurance companies to deduct, from their "gross income", 3¾% of the "mean of the *reserve funds* required by law"[1] [§ 203(a)(2)].

The only question involved here is whether, [solely with respect to their "contracts of *combined* life, health, and accident insurance"], the Companies are entitled to deduct 3¾% of the Reserve

[1] For all Benefits (i. e., Death and Disability Benefits);

or

[2] For Death Benefits only.

[1] For convenience, we will generally speak of "reserve" or "reserve funds", when strictly we are referring to "*mean of* the reserve funds", held at the beginning and end of the taxable year [§ 203(a)(2)].

For brevity, this Brief will restrict its Statement of Facts, and its Argument, to (*a*) the $1,144.34 disputed tax [1932] of New World, and (*b*) the $1,293.50 disputed tax [1934] of Oregon Mutual.[2]

The questions presented are whether New World and Oregon Mutual respectively had the right to deduct 3¾% of the "reserve funds required by law" in respect to their Disability Benefits for both Active and Disabled Lives, to-wit;

NEW WORLD LIFE [1932]

[1] Reserve for *Disability* Benefits only		[2] Total	[3] Deduction 3¾% of [2]	[4] Disputed Tax 13¾% of [3]
Active Lives	$90,725.50	$221,932.00	$8,322.45	$1,144.34
Disabled Lives	131,206.50			

OREGON MUTUAL LIFE [1934]

[1] Reserve for *Disability Benefits* only		[2] Total	[3] Deduction 3¾% of [2]	[4] Disputed Tax 13¾% of [3]
Active Lives	$111,127.58	$250,861.09	$9,407.29	$1,293.50
Disabled Lives	$139,733.51			

[2] As the New World's 1929-'30-'31 taxes, and the 1933 Oregon Mutual tax are identical except as to amounts.

To simplify the dispute, Oregon Mutual conceded below that the deficiency notice was correct as to all items, *except* as to the $1197.91 [1933 tax] and the $1293.50 [1934 tax] (R38-43).

RELEVANT STATUTES

[REVENUE ACT OF 1932; 47 Stat. c. 209, pp. 169, 223-4]
[REVENUE ACT OF 1934; 48 Stat. c. 277, pp. 680, 731-2]

The Revenue Acts of 1932 and 1934, first, *defined* a "life insurance company", and its gross income, as follows:

Supplement G—Insurance Companies

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(a) DEFINITION.—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts **(including contracts of combined life, health, and accident insurance)**, the **reserve funds** of which held for the fulfillment of **such contracts** comprise more than 50 per centum of its **total reserve funds**. . . .

SEC. 202. GROSS INCOME OF LIFE INSURANCE COMPANIES.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents. . . .

§ 201(b)(1), then, levied a 13¾% tax upon the company's "net income". Its "net income" was specifically defined as follows:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) GENERAL RULE—In the case of a life insurance company the term "net income" means the gross income *less* . . .

(2) RESERVE FUNDS—An amount equal to 4 per centum of **the mean of the reserve funds required by law** and held at the beginning and end of the taxable year, except that in the case of any such **reserve fund** which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. . . .

The Government's Unique Construction of §§ 201, 203 is in Direct Conflict with B. T. A. and C. C. A. [1st, 5th, and 9th Circuits].

In October 1938, the Government originated a most remarkable construction of §§ 201(a), 203(a)(2) to-wit, that "reserve funds" should be *limited* to Reserve for *Death* Benefits only; and thereby *excluded* Reserve for *Disability* Benefits (*New World Life* v. *U. S.*, 26 F. Supp. 444; here on *certiorari*, No. 2 October Term 1940).

The Court of Claims adopted that unique construction (apparently without any independent consideration, p. 18, *infra*), by incorporating into its Opinion a *verbatim* copy, or almost *verbatim* paraphrase, of the Government's Brief [See p. 19, *infra* for a parallel column illustration].

The Court of Claims' construction was not only contrary to the plain language of the Act [2a]; contrary to the Commissioner's fourteen years of uniform administrative construction [3]; contrary to the Board of Tax Appeals' settled construction [4]; contrary to the decisions in three Circuit Courts of Appeals, viz., 1st, 5th and 9th Circuits, each of which considered and summarily rejected [5] the singular views of the Court of Claims; but, most striking of all, it is directly contrary to the construction given five years ago by the same Court of Claims, and by the same five Judges in *Continental Assur. Co.* v. *U. S.*, 8 F. Supp. 474 (see p. 17, *infra*).

[2a] § 245(a)(2) [1921], 42 Stat. 261; 1924, 43 Stat. 289; 1926, 44 Stat. 47]; § 203(a)(2) [1928, 45 Stat. 843; 1932, 47 Stat. 224; 1934, 48 Stat. 732; 1936, 49 Stat. 1711; 1938, 52 Stat. 523; 1939, 53 Stat. 865].

[3] Art. 681, Regulations Nos. 62, 65, 69; Art. 971, Regulations Nos. 74, 77.

[4] *Equitable Life Assur. Society*, 33 B. T. A. 708; *Monarch Life Insurance Co.*, 38 B. T. A. 716; *Pan-American Life Insurance Co.*, 38 B. T. A. 1430; *Oregon Mutual Life Ins. Co.*, 39 B. T. A. 1239.

[5] *Com'r* v. *Pan-American Life*, 111 F. (2d) 366; *Com'r* v. *Oregon Mutual Life*, 112 F. (2d) 468; *Com'r* v. *Monarch Life*, 114 F. (2d) 314.

STATEMENT OF THE FACTS[6]

[NEW WORLD CASE; No. 2 OCT. TERM 1940]

1. *New World and its two kinds of policies—"Disability" and "Non-Disability".* New World is a "life insurance company" precisely as defined in § 201(a) (New World R18, 47; Government's Brief in Court of Claims p. 124).

New World issued both "Disability" and "*Non*-Disability" policies; but it never issued any *separate* "accident and health insurance" contracts (Id.).

New World calculated the Premiums and Reserves for both its "Disability" and "*Non*-Disability" policies in strict accordance with the fundamental principles governing those subjects.[7]

2. *New World's business, and the Reserves therefor.* In 1932, New World had in force both "Disability" and "*Non*-Disability" life insurance policies, for which the Reserves were as follows (§ 203(a)(2); New World R17, 29-30):

---

[6] In referring to the two different kinds of policies issued by the Companies, this Brief will adopt the convenient terminology used by the New York Courts, by the Board of Tax Appeals, by the C. C. A., and by the Government, as follows:

(1) **"Disability"** policy:—providing *"combined* life, health and accident insurance", *i. e.* both Disability Benefits *and* Death Benefits.

(2) **"Non-Disability"** policy:—providing Death Benefits *only;*

[*Rhine* case, 248 App. Div. at pp. 122, 128; *Oregon Mutual* case, 39 B. T. A. 1239; 112 F. (2d) 468, 469; Government's Brief, pp. 2-3.]

A **"Disability"** policy is *not* divisible into two *separate* contracts, viz. (*a*) one of "life insurance" with Death Benefits only, and (*b*) another of "accident and health insurance" with Disability Benefits only. It is a "single integral insurance contract" (New World R17, 18, 25-26, 61; Oregon Mutual R93, 155-7; pp. 20-24, *infra*).

[7] New World R27-30; see p. 41, note [21], *infra* for full citation of leading cases.

Table I: "Disability" Policies and "Non-Disability" Policies.

Policies	1932 Reserves
"*Non*-Disability" [contracts of life insurance only] . . .	$5,000,000[8]
"Disability" ["contracts of *combined* life, health and accident insurance" [§ 201(a)]	3,348,259[8]
TOTAL RESERVE FUNDS	$8,348,259[8]

Undisputed

First: There is absolutely *no controversy* about "*Non-Disability*" policies, or

(1) The total Reserves thereon amounting to the above—**$5,000,000.**

Second: There is absolutely *no controversy* about "Disability" policies, in so far as the Reserve for *Death* Benefits is concerned, or

(2) $3,126,327 [**a part of** the above **$3,348,259**].

Undisputed

Sole Dispute

Third: The controversy in this case arises solely with respect to "Disability" policies; and, even as to them, only with respect to

(3) **$221,932** Reserve for *Disability* **Benefits** [being the *remaining part* of the above **$3,348,259** total Reserve for "Disability" policies] subdivided as shown in **Table II** below.

Sole Dispute

In 1932, New World's total Reserves for its *future, unaccrued* and *contingent* obligations under all its "contracts of *combined* life, health and accident insurance", *i. e.* "Disability" policies, were as follows:

[8] The total Reserve of $8,348,259 is exact (New World R17, 29-30). The apportionment thereof between "Disability" and "*Non*-Disability" Reserves is approximate only, but it will serve for illustration.

Table II: "Disability" Policies Only.

Benefits		1932 Reserves	
Death Benefits		$3,126,327.00[9]	
Disability Benefits	Active Lives	90,725.50	$221,932.00
	Disabled Lives	131,206.50	
TOTAL		$3,348,259.00	

3. *Government's exclusion of* **$221,932** *Reserve for Disability Benefits.* The Government contends that New World is not entitled to a deduction of 3¾% of the above **$221,932** Reserves for *Disability Benefits;*—This disputed deduction [$8,322.45] resulted in the disputed $1,144.34 tax (p. 2, *supra*).

Thus the entire controversy is over the **$221,932** Reserve for the *Disability Benefits.*

4. These **$221,932** Reserves for *Disability Benefits* were all concededly *"required by law"* [Government's Brief in Court of Claims, pp. 101-102; Opinion Court of Claims, New World R29-30].

5. *The Sole Question Involved.* In determining the amount of New World's "reserve funds" under § 203(a)(2), is the Government right or wrong in omitting the above **$221,932**?

This **$221,932** was not only *"required by law,"*; but it also was the *absolutely essential* Reserve for Disability Benefits which were an integral part of the "contracts of *combined* life, health and accident insurance" [§ 201(a)].

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[9] As there was no dispute over the $3,126,327 Reserves for the *Death* Benefits under the "Disability" policies, the Government raises no question over New World's right to a deduction of 3¾% of the above $3,126,327 Reserve for *Death* Benefits

This was because **$221,932** was the mathematically calculated measure of New World's *future, unaccrued and contingent obligations for Disability Benefits only,* for both

(*a*) *Active Lives* [$90,725.50]; *i. e.* Those policyholders who *might* become disabled *in the future;* in which event, New World would be *contingently* bound to pay Disability Benefits, to-wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 44-45, *infra*); and

(*b*) *Disabled Lives* [$131,206.50]; *i. e.* Those policyholders who had *already become disabled,* and to whom New World was *contingently* bound to pay Disability Benefits, to-wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 46-47, *infra*).

The controversy here is limited to New World's right to deduct $8,322.45, to-wit 3¾% of **$221,932.00** Reserve for *Disability Benefits* in "*Disability*" policies only (pp. 2, 6, *supra;* 8, *infra*) as to which, the following are

6. *The Contentions of the Parties.*

New World's Contention. New World contends that "reserve funds" [§ 203] embrace the entire $3,348,259—which is the mathematically calculated Reserve to meet *all* its *unaccrued* "Disability" policy obligations [for Death *and Disability*] *which are dependent upon future life and Disability contingencies* [Table I, p. 6, *supra*]—and

thereby automatically embrace the disputed **$221,932** [Table II, p. 7, *supra*].

Government's Contention. As to "Disability" policies, the Government contends that "reserve funds" embrace only the $3,126,327 undisputed Reserve for *Death Benefits only* [Table II, p. 7, *supra*]; and, consequently, that the 3¾% deduction allowed by § 203(a)(2) must be computed solely on the basis of such $3,126,327.

The Government reaches this $3,126,327 figure by the easy, ***but arbitrary,*** method of

FIRST: Allowing all Reserves [$3,126,327] for the *Death* Benefits in "Disability" policies; but

SECOND: *Disallowing* all Reserves [**$221,932**] for *Disability* Benefits; although such Benefits were contained in, and were an integral part of, New World's "contracts of *combined* life, health and accident insurance", which § 201(a) expressly describes as being *one kind* of "*life* insurance contracts".

The sole issue. At last, the sole question is whether the phrase "reserve funds" used in § 203(a)(2) includes, or does not include, the **$221,932** Reserve for Disability Benefits [p. 6, *supra;* Table II, p. 7, *supra*].

To summarize:

"DISABILITY" POLICIES	
New World says Reserve was	$3,348,259.00
Government says Reserve was [*Death* Benefits only]	3,126,327.00
Government excludes Reserve for *Disability* Benefits	$ 221,932.00
Government disallows 3¾% deduction [§ 203(a)(2)]	8,322.45
Government claimed tax deficiency of 13¾% of $8,322.45	1,144.34

7. ***The Court of Claims' Opinion.*** **As already shown, the Court of Claims adopted the Government's construction of §§ 201(a), 203(a)(2) p. 4, *supra;* and decided against New World (New World R32, 46-60; 26 F. Supp. 444). A review of its Opinion will be postponed until after stating the facts in the *Oregon Mutual* case (See p. 17, *infra*).**

STATEMENT OF FACTS

No. 564. October Term, 1940

***Commissioner of Internal Revenue* v. *Oregon Mutual Life Ins. Co.*, 112 F. (2d) 468**

STATEMENT OF FACTS

No. 864. October Term, 1940

Commissioner of Internal Revenue v. Oregon Mutual
Life Ins. Co., 112 F. (2d) 468

STATEMENT OF FACTS [6]

[OREGON MUTUAL CASE; No. 564 OCT. TERM 1940]

1. ***Oregon Mutual and its two kinds of policies—"Disability" and "Non-Disability".*** Oregon Mutual is a "life insurance company" precisely as defined in § 201(a) (Oregon Mutual R47; Government's Brief in C. C. A. p. 8).

Oregon Mutual issued both "Disability" and "*Non*-Disability" policies; but it never issued any *separate* "accident and health insurance" contracts (Oregon Mutual R93).

Oregon Mutual calculated the Premiums and Reserves for both its "Disability" and "*Non*-Disability" policies in strict accordance with the fundamental principles governing those subjects.[10] [B. T. A.'s Findings, Oregon Mutual R45, 46; See illustrative Tables A, B, and D, Oregon Mutual R79, 91, 110.]

2. ***Oregon Mutual's business, and the Reserves therefor.*** In 1934, Oregon Mutual had in force a total of about 25,000 "Disability" and "*Non*-Disability" life insurance policies, for which the $10,025,706.38 Reserves were as follows [§ 203(a)(2); Oregon Mutual R44-46, 64, 65; Government's Brief in C. C. A. pp. 2-4]:

Table I: "Disability" Policies and "*Non*-Disability" Policies.

Policies	1934 Reserves
"*Non*-Disability [contracts of life insurance only]	$6,093,400.64
"Disability ["contracts of *combined* life, health and accident insurance" (§ 201(a))]	3,932,305.74
TOTAL RESERVE FUNDS	$10,025,706.38

[6] See note [6] p. 5, *supra.*

[10] Oregon Mutual R67-116; see p. 41, note [21], *infra* for full citation of leading cases.

Undisputed

First: There is absolutely *no controversy* about "*Non-Disability*" policies, or

(1) The total Reserves thereon amounting to the above—**$6,093,400.64.**

Second: There is absolutely *no controversy* about "Disability" policies, in so far as the Reserve for *Death* Benefits is concerned, or

(2) $3,681,441.65 [**a part of** the above **$3,932,305.74**].

Undisputed

Sole Dispute

Third: The controversy in this case arises solely with respect to "Disability" policies; and, even as to them, only with respect to

(3) **$250,861.09** Reserve for *Disability* **Benefits**[11] [being the *remaining part* of the above **$3,932,305.74** total Reserve for "*Disability*" policies] subdivided as shown in **Table II** below (Oregon Mutual R42, 45, 65, p. 2, *supra*).

Sole Dispute

In 1934, Oregon Mutual's $3,932,305.74 Reserves for its *future, unaccrued* and *contingent* obligations under all its "contracts of *combined* life, health and accident insurance", *i. e.* "Disability" policies, were as follows (Id.).

[11] B. T. A. Opinion Oregon Mutual R44, note 3, 46; Government's Brief in C. C. A., pp. 2-3.

Table II: "Disability" Policies Only.

Benefits		1934 Reserves	
Death Benefits		$3,681,444.65 [12]	
Disability Benefits	Active Lives	111,127.58	$250,861.09
	Disabled Lives	139,733.51	
	TOTAL	$3,932,305.74	

3. *Commissioner's exclusion of* **$250,861.09** *Reserve for Disability Benefits.* The Commissioner *disallowed* a deduction of 3¾% of the above **$250,861.09** Reserves for *Disability Benefits;*—This disallowed deduction [$9,407.29] resulted in the $1,293.50 tax deficiency (p. 2, *supra,* Government's Brief in C. C. A. p. 4, Table).

Thus, the entire controversy is over the **$250,861.09** Reserve for the *Disability Benefits,* which Benefits are an integral part of the *policies* specifically designated in § 201(a) as "contracts of *combined* life, health and accident insurance", *i. e.,* "Disability" policies (pp. 2, 12, *supra*).

4. These **$250,861.09** Reserves for Disability *Benefits* were all expressly concededly *"required by law"* [Government's Brief in C. C. A., pp. 3, 22; B. T. A.'s Findings Oregon Mutual R47, 139; C. C. A.'s Opinion, 112 F. (2d) at p. 469].

5. *The Sole Question Involved.* In determining the amount of Oregon Mutual's "reserve funds" under § 203(a)(2), was the Commissioner right or wrong in omitting the above **$250,861.09**?

This **$250,861.09** was not only *"required by law,"*; but it also was the *absolutely essential* Reserve for Disability Benefits which were an integral part of the "contracts of *combined* life, health and accident insurance" [§ 201(a)].

[12] As there was no dispute over the $3,681,444.65 Reserves for the *Death* Benefits under the "Disability" policies, the Commissioner properly allowed a deduction of 3¾% of the above $3,681,444.65 Reserve for *Death* Benefits (B. T. A. Opinion, Oregon Mutual R46; Government's Brief in C. C. A., p. 3).

This was because **$250,861.09** was the mathematically calculated measure of Oregon Mutual's *future, unaccrued and contingent obligations for Disability Benefits only,* for both

(*a*) *Active Lives* [$111,127.58]; *i. e.* Those policyholders who *might* become disabled *in the future;* in which event, Oregon Mutual would be *contingently* bound to pay Disability Benefits, to wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 44-45, 48, *infra;* and

(*b*) *Disabled Lives* [$139,733.51]; *i. e.* Those policyholders who had *already become disabled,* and to whom Oregon Mutual was *contingently* bound to pay Disability Benefits, to-wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 46-48, *infra*).

The controversy here is limited to Oregon Mutual's right to deduct $9,407.29, to-wit 3¾% of **$250,861.09** Reserve for *Disability Benefits* in "*Disability*" policies only (pp. 2, 12, 13, *supra;* 43-49, *infra*), as to which, the following are

6. *The Contentions of the Parties.*

Oregon Mutual's Contention. Oregon Mutual contends that "reserve funds" [§ 203(a)(2)] embraces the entire $3,932,305.74—which is the mathematically calculated Reserve to meet *all* its *unaccrued* "Disability" policy obligations [for Death *and Disability*] *which are dependent upon future life and Disability contingencies* [Table I, p. 11, *supra*] and thereby automatically embraces the disputed **$250,861.09** [Table II, p. 13, *supra*].

Commissioner's Contention As to "Disability" policies, the Commissioner contends that "reserve funds" embraces

only the $3,681,444.65 undisputed Reserve for *Death Benefits only* [Table II, p. 13, *supra*]; and, consequently, that the 3¾% deduction allowed by § 203(a)(2) must be computed solely on the basis of such $3,681,444.65 [Government's Brief in C. C. A. pp. 3, 5-6].

The Commissioner reached this $3,681,444.65 figure by the easy, *but arbitrary*, method of

FIRST: Allowing all Reserves [$3,681,444.65] for the *Death* Benefits in "Disability" policies; but

SECOND: *Disallowing* all Reserves [**$250,861.09**] for *Disability* Benefits; although such Benefits were contained in, and were an integral part of, Oregon Mutual's "contracts of *combined* life, health and accident insurance" which § 201(a) expressly described as being *one kind* of "*life* insurance contracts".

The sole issue. At last, the sole question is whether the phrase "reserve funds" used in § 203(a)(2) includes, or does not include, the **$250,861.09** Reserve for Disability Benefits [pp. 2, 12, note *supra;* Table II, p. 13, *supra*].

To summarize:

"DISABILITY" POLICIES	
Oregon Mutual says Reserve was	$3,932,305.74
Commissioner says Reserve was [*Death* Benefits only]	3,681,444.65
Commissioner excluded Reserve for *Disability* Benefits	**$ 250,861.09**
Commissioner disallowed 3¾% deduction [§ 203 (a)(2)]	$ 9,407.29
Commissioner asserted tax deficiency of 13¾% of $9,407.29	$ 1,293.50

7. *The B. T. A.'s Findings of Fact (R44-47).* The Board of Tax Appeals' Findings of Fact were, that,

I. Oregon Mutual's $111,127.58 Active Life Reserve was designed "to meet **future, unaccrued and contingent** lia-

bilities under those disability policies the holders of which have not incurred disabilities" (Oregon Mutual R45, 46);

II. Oregon Mutual's $139,733.51 Disabled Life Reserve was designed to enable Oregon Mutual "to pay disability benefits **to become due in the future** as long as the disabled policyholder **remains alive** and disabled" (Id.); and

III. "There is no duplication between these two reserves" (Id.).

B. T. A. Decision

8. *The B. T. A.'s Decision.* In accordance with its elaborately considered prior opinions, the Board of Tax Appeals decided [13] (Oregon Mutual R43, 47-49);

I. Active and Disabled Life Reserves are "reserves required by law" within the meaning of § 203(a)(2);

II. Oregon Mutual was entitled to deduct $9,407.29 from its "gross" income, as 3¾% of the **$250,861.09** Active and Disabled Life Reserves; and it did not owe the $1,293.50 alleged tax deficiency for 1934.

C. C. A. Decision

9. *C. C. A. Decision* [*Com'r* v. *Oregon Mutual,* 112 F. (2d) 468]; The C. C. A. (9th) affirmed the B. T. A.'s decision (R193).

On November 9, 1940, the Commissioner petitioned for *certiorari,* which was granted on November 12, 1940.

[13] *Equitable Life Assurance Society,* 33 B. T. A. 708; and *Monarch Life Ins. Co.,* 38 B. T. A. 716; *Pan-American Life Ins. Co., Id.* 1430, which, with the case at bar, have since been respectively *affirmed* by the C. C. A. (1st, 5th, 9th) in 114 F. (2d) 314; 111 F. (2d) 366; and 112 F. (2d) 468.

10. Court of Claims' Opinion in New World Life Case. [26 F. Supp. 444: R32-60]

The Court of Claims held that the term "reserve funds" in § 203(a)(2),

[1] *Included* all Reserves for Death Benefits—a conclusion with which all the Courts are agreed; but

[2] *Did not include* the Reserves held for the fulfillment of a life insurance company's obligation to pay Disability Benefits, included in "contracts of *combined* life, health and accident insurance".

The Court of Claims' conclusion is,

(*a*) **Directly contrary** to the decisions of the Board of Tax Appeals, reached in a series of carefully considered opinions, spread over five years, and delivered by three different members of the B. T. A., unanimously concurred in by twenty-two other different members of the B. T. A.; and

(*b*) **Directly contrary** to the decision of three different Circuit Courts of Appeals (1st, 5th and 9th), representing the unanimous judgment of eight Circuit Judges and one District Judge, whose opinions showed a thorough understanding of all the technical features involved, their careful consideration, and a consistent result.

Furthermore, the Court of Claims' decision by LITTLETON, J. (concurred in by BOOTH, GREEN, WHALEY and WILLIAMS, JJ.) is unconsciously in direct conflict with the same Court of Claims' prior decision in *Continental Assur. Co.* v. *U. S.,* 8 F. Supp. 474, rendered by exactly the same five Judges. In the *Continental* case, the Court of Claims held that "reserve funds" in § 245(a)(2) [which is identical with § 203(a)(2) of the 1932 Revenue Act] was *not*

restricted to reserves for Death Benefits only, but that it included all technical insurance reserves "to meet existing unmatured insurance, **whether fire, marine or life insurance**" (pp. 51-52, *infra*).

The Court of Claims' new and contrary Opinion should not be given any independent weight here, because:

1. That part of its Opinion construing "reserve funds", as used in § 203(a)(2), does not represent its own consideration and determination of the subject (New World R46-59).

This is shown by two circumstances:

(*a*) The Court of Claims did not simply *overlook* the *Continental Assur. Co.* case, as it was cited and relied on (New World R53, 57, 59). Nevertheless in the *New World* case, the Court gave to the words "reserve funds" in § 203(a)(2) a meaning which was directly in conflict with the meaning which (in the *Continental* case five years before), it had given to those same words in the same section.

(*b*) As its Opinion in the *New World* case, the Court of Claims adopted practically a *verbatim* copy of the Government's Brief on the subject of "reserve funds". As that Brief did not call attention to the obvious conflict between the prior construction of "reserve funds" in the *Continental* case, and the new construction which the Government was urging the Court of Claims to adopt, the latter apparently failed to notice the conflict, **and unconsciously overruled its former decision.**

The following parallel column comparison indicates the extent to which the Court of Claims' Opinion was a mere adoption of the Government's Brief:

Identic or almost identic language in	
Opinion of Ct. of Claims [26 F. Supp. 444]	Government's Brief in Ct. of Claims
Page	Page
460	105, 106, 123
461	123-126
462	126-129
463	129-132
464	132-135
465	135-137
466	137-140

2. The Court of Claims' Opinion, as copied from the Government's Brief, rests on several fundamental errors of fact, which vitiate, and render unnecessary any detailed refutation of its involved reasoning; which errors may be briefly summarized as follows:

(a) The Court of Claims' Opinion arbitrarily calls all "accident and health" insurance, "*casualty* insurance", and calls the Reserves therefor "casualty reserves" some *sixteen times* [see pp. 460-465; New World R46-57].

The Opinion then treats such so-called "*casualty*" insurance, as if it were always contained in a *separate policy* wholly distinct from, and independent of, life insurance [Death Benefits], thereby simply ignoring Congress's recognition of, and express provision for

> "life insurance and annuity contracts (*including* contracts of *combined* life, health and accident insurance)" [§ 201(a)],

as "unimportant" (p. 465; New World R56).

The Opinion thus ignores as "unimportant" the vital fact that there *are* (1) *separate* "accident and health" policies, and also (2) *combined* life, health and

accident policies—the existence of which two different kinds of policies are recognized and separately provided for in § 201(a) (pp. 28, 33-37, *infra*),

(*b*) The Court of Claims' Opinion is guilty of a plain *error* of fact, as well as of law, when it says (p. 465; New World R56);

> "The health and accident portion of the combined policies are entirely *separate contracts, New York Life Ins. Co.* v. *U. S.*, 12 F. (2d) 643.[14] . . . . The specimen policy in evidence in this case shows that with the page covering casualty insurance *removed* it is a complete life insurance policy . . . The two contracts are as separate and distinct as if written in separate policies."

This is simply not a fact. While a physical removal of the page entitled "Total and Permanent Disability Benefits" from the New World policy would leave a "complete life insurance policy" (R66);—**the converse is absolutely false.** If "the page covering casualty insurance [were] removed", **no "casualty insurance" would remain;** and the casualty insurance contract is *not* "as separate and distinct as if written in a separate policy". This is because [as so forcibly pointed out in both the *Rhine* and *Rubin* cases, pp. 22-24, *infra*], there would be no identifiable *insurance company*; no

[14] *New York Life* v. *U. S.*, 12 F. (2d) 643, does not support what the Court of Claims cites it for. In that case, Congress imposed *one kind of tax* upon the *face amount* of life insurance [Death Benefits], and a *different kind of tax* upon the *premiums* charged for Disability Benefits and Accident Benefits. New York Life issued a policy containing both Death, Disability and Accident benefits. The Company contended that when it paid the tax upon the *face amount* of the policy, it was exempt from the further tax on the *premiums* charged for Disability and Accident Benefits. The Court (MANTON, J.) held that the payment of the tax on the *face amount* of the policy, did not relieve the company from also paying a different tax upon the *premiums* charged for Disability and Accident Benefits. Nothing else was involved in the case and it has no application whatever in determining what Congress meant by "reserve funds".

identifiable *policyholder*; no identifiable *person to receive the income benefit* due at the unidentifiable policyholder's death; no identifiable *"grace period"*; no identifiable *amount of the premium waived* in the event of disability; no identifiable *amount which is to be deducted* under certain conditions from the Disabilty Benefits; no identifiable *date* of the policy; no identifiable *date* when the premium for the Disability Benefit is payable, or the *days of grace* allowed for its payment; no identifiable *date* when the unidentifiable policyholder *may discontinue* the Disability Benefits and thereby reduce the amount of his premium; no identifiable *date* of the policy *from which to determine* whether the disability is covered; no identifiable *beneficiary* to receive the monthly income in the event of the unidentifiable policyholder's mental incapacity, etc.

Those vital omissions from New World's "page covering casualty insurance" demonstrate that the so-called casualty insurance contract is not as "separate and distinct as if written in a separate policy"; but the so-called casualty insurance is utterly "meaningless" and "unintelligible" except when read *as an integral part* of the life insurance provisions of the policy. Those are the reasons why the New York and California Courts have held that such a "Disability" policy is

> "a single policy, with both 'Death and Disability' benefits so interwoven as to constitute **a single integral insurance contract**";

and that if the accident and health provisions were

> "taken together **apart** from the rest of the policy it would be impossible to spell out a separate contract for disability insurance"; they are **"unintelligible** without the death benefit provisions"; are **"incomplete and meaningless** . . . and fail to disclose most of the essential terms"; and the life, accident and health provisions **"constitute a single instrument, both by**

physical union and in legal effect" [See pp. 22-24, 58-60, *infra*].

In *Rhine* v. *New York Life Insurance Co.*, 248 App. Div. 120; 273 N. Y. 1 the New York Life's "Disability" policy of "*combined* life, health and accident insurance" contained both Death Benefits and Disability Benefits, with a provision that the insured might, at any time, discontinue the Disability Benefits, and thereafter the premium payable should be reduced by the amount charged for the Disability Benefits. That case involved the question whether a "Disability" policy was *one* contract, or consisted of *two* contracts—one for *life* insurance, and the other for *disability* insurance.

In rejecting Mrs. Rhine's contention [which is the Government's contention here] that the policy consisted of *two* complete agreements of insurance, *one* for life insurance and *the other* for disability insurance, the Appellate Division said (pp. 133-135):

> "We reach the conclusion that the policy is one agreement, a single policy, with both death and disability benefits so interwoven as to constitute **a single integral insurance contract** • • • A consideration of the provisions for disability benefits makes it clear that if all of these provisions were taken together apart from the rest of the policy, it would be impossible to spell out a separate contract for disability insurance; there would be no identifiable company, no identifiable sum to be paid (for the disability benefits cannot be obtained without the death benefit), and no identifiable person to receive the payment. The provisions for disability benefits are so intimately dependent upon and unintelligible without the death benefit provisions as to be by themselves impossible of constituting a separate contract. • • • A single set of promises arising in connection with life insurance and with disability insurance are

> closely interwoven and dependent one upon the other. The disability benefits are issued only when the terms thereof are printed in a life insurance policy, they cannot be obtained separately and cannot be continued in force independently of the death benefit in the policy. * * * **the policy is a single contract** containing various provisions and various promises * * * but the policy cannot be taken, as plaintiff contends, as the equivalent of two separate policies, one the exact equivalent of a policy of life insurance with merely a death benefit, and the second an independent contract or policy covering disability benefits. * * * were the life insurance provision stricken out at the outset there would have been no contract whatever, as disability benefits are issued only when the terms thereof are printed in a life insurance policy; they cannot be separately obtained."

In affirming the Appellate Division, the Court of Appeals acutely analyzed the nature of both "Disability" and "*Non*-Disability" policies and held that the Death Benefits and Disability Benefits were "integral parts of a single policy" (273 N. Y. at p. 15). The Court (LEHMAN, J.) also said (p. 7):

> " . . . the aggregate premiums received by the company and the interest earned on its investments create one general fund from which are paid the death and *disability* claims, endowments, surrender value and other claims, the expense of conducting the business, including depreciation in investment values, and all other obligations of the company; and out of which also the reserves are maintained."

In *Rubin* v. *Metropolitan Life Insurance Co.*, 251 App. Div. 382; 278 N. Y. 625, the Disability Benefits were even printed in a separate "rider" form entitled "Supplementary Contract" separately dated, signed by the company officials, and pasted on the policy, [instead of being contained in a *paragraph* of the life insurance policy, as in the Oregon Mutual (R155-7), New World, and New York Life].

Even in such a case of a *separate* "rider" providing for Disability Benefits, the Appellate Division, affirmed by the Court of Appeals, said:

> "The distinction, however, is one of form only. No difference exists between the two methods of including disability benefits in a policy of life insurance.
>
> In neither case do the disability provisions constitute separate contracts of insurance, • • •. • • • if the life insurance should lapse, the disability benefits would not survive nor could they be continued. The disability "rider," taken alone, is incomplete and meaningless and, except by reference to the remaining provisions of the policy, fails to disclose most of the essential terms. Moreover, the policy describes itself many times as a single policy. These circumstances, without reference to many others, require the conclusion that the policy, together with the "Supplementary Contract," constitute a single instrument, both by physicial union and in legal effect."

In *Barnett* v. *Metropolitan Life Insurance Co.*, 16 N. Y. S. (2d) 198, the *Rhine* and *Rubin* cases are reaffirmed, the Court saying that the policies were "ordinary life policies *containing what are commonly termed disability benefits*". [See authorities cited p. 59 note [21], *infra*.]

The Court of Claims' fundamental error in assuming that a so-called "Disability" policy really consists of two independent contracts, leads it into a totally erroneous, and utterly unjustifiable, interpretation of the plain language of § 201(a) (pp. 28, 32-35, *infra*),—**resulting in a still further error in its interpretation of § 203(a)(2), based in turn upon the wrong interpretation of § 201(a).** [Cf. pp. 461-2, 463; New World R47-53.]

SUMMARY OF POINTS DISCUSSED.

I. [Interpretation of § 201(a)]

1. In § 201 (a), the phrase "reserve funds . . . held for the fulfillment of such contracts" is not restricted [as the Commissioner contends it is] to Reserve for Death Benefits only; but it includes the entire Reserve held for the fulfillment of

(a) "Non-Disability" policies [Death Benefits only];

and also all

(b) "Disability" policies [Death Benefits *combined* with Disability Benefits].

2. Therefore, "reserve funds" as used in § 201(a) automatically includes the $250,861.09 disputed Reserve for the Disability Benefits contained in Oregon Mutual's "Disability" policies.

3. The Commissioner's interpretation of § 201(a)—which is contrary to the settled interpretation by the B. T. A., and by the C. C. A. (1st, 5th and 9th)—must be rejected (pp. 27-37).

II. [Nature of "Technical Insurance Reserves"]

1. In § 203(a)(2), the words "reserve funds" refer to *technical insurance reserves, i. e.* reserves held to meet a life insurance company's obligations which are entirely (a) future, (b) unaccrued, and (c) dependent upon life contingencies, or (d) dependent upon a series of life and disability contingencies.

2. For 1934 Oregon Mutual's $3,932,305.74 Reserve for "Disability" policies [including the disputed $250,861.09 Reserve for the Disability Benefits] was

the *technical insurance reserve*, mathematically calculated as the then measure of its liability for the performance of only future, unaccrued and contingent policy obligations [Death and Disability Benefits] (pp. 38-49).

III. [INTERPRETATION OF § 203(a)(2)]

In § 203(a)(2), the phrase "reserve funds" is not restricted to Reserve for Death Benefits only [as the Commissioner contends], but it also includes Oregon Mutual's $250,861.09 Active and Disabled Life Reserve for the Disability Benefits [contained in the 10,000-odd "Disability" policies], which $250,861.09 the Commissioner erroneously excluded when calculating the authorized 3¾% deduction (pp. 50-85).

FIRST POINT.*

[INTERPRETATION OF § 201(a)]

I. In § 201(a), the phrase "reserve funds . . . held for the fulfillment of such contracts" is not restricted [as the Commissioner contends it is] to Reserve for Death Benefits only; but it includes the entire Reserve held for the fulfillment of

(a) "Non-Disability" policies [Death Benefits only]; and also all

(b) "Disability" policies [Death Benefits *combined* with Disability Benefits].

II. Therefore, "reserve funds" as used in § 201(a) automatically includes the $250,861.09 disputed Reserve for the Disability Benefits contained in Oregon Mutual's "Disability" policies.

III. The Commissioner's interpretation of § 201(a) —which is contrary to the settled interpretation by the B. T. A., and by the C. C. A. (1st, 5th and 9th)—must be rejected.

§ 201(a) provided:

> "(a) DEFINITION.—When used in this title the term '*life* insurance company' means an *insurance* company engaged in the business of issuing life insurance and annuity contracts (*including contracts of combined life, health, and accident insurance*), the *reserve funds* of which *held for the fulfillment of such contracts* comprise more than 50 per centum of its *total reserve funds.*"

§ 201(a) admittedly refers only to "technical insurance reserves".[15]

* In view of the identity of the questions in the *New World* and *Oregon* cases, and in order to save this Court's time and labor, the Argument will be based on Oregon Mutual's 1934 disputed $1,293.50 tax. Unless otherwise indicated, all subsequent references to the Record will be to the Record in the *Oregon Mutual* case.

[15] Refer to bottom of p. 28 for this note.

I. Proper Construction of § 201(a).

§ 201(a) thus expressly defines a "*life* insurance company" as "an *insurance* company"

[A] "issuing life insurance and annuity contracts (*including* contracts of *combined* life, health and accident insurance),

This clause **[A]** embraces *every kind* of life insurance policies—both "Disability" policies as well as "*Non*-Disability" policies.

[B] the reserve funds of which held for the fulfillment of *such contracts*

This clause **[B]** refers to the "reserve funds" held for *all* life insurance policies, *i. e.*, both the above described "Disability" policies, and, "*Non*-Disability" policies—all as designated in **[A]**.

[C] comprise more than 50 per centum of its *total reserve funds*".

This clause **[C]** establishes a ratio between **[B]**—the "reserve funds" already designated as held for both "Disability" and "*Non*-Disability" policies, —and **[C]**—"its *total* reserve funds", *i. e.*, reserve funds for "Disability" policies, and "*Non*-Disability" policies, *plus* the reserve funds for *every other type* of insurance, *if any*, which the "insurance" company has outstanding.

[15] See pp. 39 note [20], 41-42, *infra; New World Life* v. *U. S.*, 26 F. Supp. 444, 462 [Ct. Cls.]; *Com'r* v. *Oregon Mutual Life*, 112 F. (2d) 468, 470 (C. C. A. 9th); *Com'r* v. *Monarch Life*, 114 F. (2d) 314, 324-5 (C. C. A. 1st); Government's Brief in C. C. A., p. 19.

These parallel columns show, at a glance, that the phrase "reserve funds" in [**B**] necessarily includes [contrary to the Commissioner's contention] the Reserve for *Disability* Benefits in "contracts of *combined* life, health and accident insurance", *as well as* the Reserve for *Death* Benefits.

In *Pan-American Life Insurance Co.*, 38 B. T. A. 1430, 1440, the B. T. A., properly construed § 201(a) saying:

> "In this definition there can be no doubt but that Congress intended the term 'reserve funds' to apply to 'contracts of combined life, health and accident insurance' as well as to 'life insurance and annuity contracts.' "

The C. C. A. (9th) held the same thing in *Commissioner* v. *Oregon Mutual Life* 112 F. (2d) 468, 470 saying:

> "Considerable light is thrown on the problem by the provisions of § 201(a) of the act. . . .
>
> As applied, for example, to this taxpayer, the Commissioner construes the statute as meaning that the determinative ratio is between the *non*-disability elements of the company's reserves and a total comprising these *plus* the reserves held for the fulfillment of the disability features of its *combined* policies.
>
> The statute, however, says that the reserve funds which are to be compared with the total shall comprise reserves held 'for the fulfillment of such contracts'—namely, the contracts enumerated. These expressly include 'contracts of *combined* life, health, and accident insurance'. For the purpose of classification, the disability reserves held against the *combined* policies are treated by the act as *life* insurance reserves. Neither the Commissioner nor the court is at liberty to disregard the plain language of the section on the theory that the classification lacks philosophical basis. It must be borne in mind that we are dealing with a statute, not with an actuarial problem."

This *correct* construction of § 201(a) destroys the Commissioner's construction, which *erroneously assumes* that

the phrase—"reserve funds *of which* . . . "—includes only reserve for *Death* Benefits, but *not* reserve for *Disability* Benefits—even when *"combined"* with life insurance.

The Government's erroneous construction—absolutely contradictory to the plain language of § 201(a)—vitiates its subsequent construction of § 203(a)(2), which construction, in turn, is solely based upon its prior erroneous interpretation of § 201(a).

II. "Reserve funds" under § 201(a) includes Oregon Mutual's $250,861.09 Reserve for Disability Benefits.

Oregon Mutual was a *life* insurance company, and *taxable as such* under §§ 201-203, *solely because* its Reserve for "Disability" and "*Non*-Disability" policies was "more than 50%" of its "total reserve funds" *i. e.* it was 100% (pp. 3, 11-13, *supra*, Cf. R65, 93), to wit:

On December 31, 1934, Oregon Mutual's "reserve funds . . . held for the fulfillment of *such contracts*" [to wit for "life insurance and annuity contracts (*including* contracts of *combined* life, health and accident insurance)"], were $10,025,706.38 subdivided as follows (Tables I and II, pp. 11, 13, *supra*):

			Reserve
[A]	"*Non*-Disability" policies (Death Benefits only)		$6,093,400.64
	"Disability" policies:		
	Death Benefits only	$3,681,444.65	
	Disability Benefits {Active Lives $111,127.58; Disabled Lives 139,733.51}	250,861.09	3,932,305.94
[B]	Reserve funds for "Disability" and "*Non*-Disability" policies		$10,025,706.38
[C]	Oregon Mutual's "TOTAL RESERVE FUNDS"		$10,025,706.38

The ratio of "[B]" to "[C]" is thus 100%[16]; and since such ratio was "more than 50%," Oregon Mutual thereby

[16] This ratio is 100% for Oregon Mutual only because, like many other companies, it *never* issued any *separate* "accident and health

(*Continued on p. 31*)

was a "*life* insurance company" as defined in § 201(a) [pp. 3, 11, *supra*].

The "reserve funds . . . held for the fulfillment of such contracts" **[B]**, as well as the "total reserve funds" **[C]**, automatically included the **$250,861.09** Reserve for *Disability* Benefits in controversy here.

III. The Government's interpretation of § 201(a) is purely arbitrary and must be rejected.

The Government repeatedly misconstrues § 201(a) in two respects;

First; It erroneously construes § 201(a) to require a comparison between (1) Reserves for all *Death Benefits* (*part* of **[B]**), and (2) Total Reserves **[C]**; *whereas,* § 201(a) requires a comparison between (1) Reserves for *all Death and all Disability Benefits* (*all* of **[B]**), and (2) Total Reserves **[C]** (see p. 28, *supra*);

Second; It disregards the *distinction* between (1) *separate* "health and accident" insurance, and (2) "health and accident" insurance *in combination with* life insurance, *i. e. Disability* Benefits in "Disability" policies [§ 201(a)].

The Government's construction must be promptly rejected, for the following reasons:

(1) It directly conflicts with the plain and unambiguous language of § 201(a) as analyzed at page 28, *supra;*

(2) It construes § 201(a) *as if it contained,* [which it does *not* contain], the following *italicized* words, *i. e.*

> "held for the fulfillment of *the Death Benefits only in* such contracts";

(*Continued from p. 30*)
insurance". In the case of those companies which issued *separate* "accident and health insurance" however, this ratio of **[B]** to **[C]** may, or may not, be "more than 50%" of their "total reserve funds", depending entirely upon the extent of their *separate* "accident and health" business (*Monarch Life Insurance Co.,* 38 B. T. A. 716; Id. 801; *Com'r* v. *Monarch Life,* 114 F. (2d) 314).

whereas, § 201(a) used no such limiting words; but it used the all-embracing phrase "held for the fulfillment of *such* contracts". It thereby directly referred to contracts of "*combined* life, health and accident insurance", as well as to "*Non*-Disability" policies (see **[B]**, pp. 28-31, *supra*);

(3) It erroneously assumes that Oregon Mutual's "Disability" policies consisted of two entirely *separate* contracts (a) one of "life" insurance only, and (b) another of "accident and health" insurance *only,*—as separate and distinct as if written in two entirely separate policies; and that the Disability Benefits, [which are an integral part of Oregon Mutual's "contracts of *combined* life, health and accident insurance," *i. e.* "Disability" policies,] constitute a *separate* "accident and health insurance" contract.

The Court of Claims said (26 F. Supp. at p. 465):

> "The health and accident portion of the combined policies are *entirely separate* contracts, *New York Life Ins. Co.* v. *U. S.*, 12 F. (2d) 643.[17] . . . The specimen policy in evidence in this case shows that with the page covering casualty insurance *removed* it is a complete life insurance policy . . . The two contracts are as *separate and distinct* as if written in separate policies."

This is simply not a fact [See pp. 20-24, *supra;* 33, 58-60, *infra.*]

In Oregon Mutual's policy, all the provisions for "Disability Benefits" are contained in one Paragraph, XIV, *printed in* the policy just as the other fifteen Paragraphs are printed, covering "Loans and Surrender values", "In-

[17] See p. 20 note [14] *supra* which distinguishes *New York Life* v. *U. S.*

contestability", "Settlement at maturity of policy", "Policy and Application the Entire Contract", etc. Paragraph XIV could not be *physically removed* from the policy [as the Court of Claims indicated that "the page covering casualty insurance [might be] removed" leaving "a complete life insurance policy"] because Paragraph XIX was not on a page by itself. If Paragraph XIV were cut out with a pair of scissors, then the copy of the Application (on the *reverse* side of the page) would be mutilated beyond recognition. This would destroy the contract itself by physically emasculating a copy of the Application, which, by Statute, *must be a part of the contract.*

On the other hand, if instead of cutting out Paragraph XIV with scissors, it should merely be obliterated by lines drawn through it, there would be no Disability Benefits whatever (see pp. 20-24, *supra*).

Oregon Mutual's "Disability" policies are **single integral insurance contracts**, in which the Disability Benefits are so intimately interwoven with the Death Benefits, that it is impossible to spell out a disability contract of insurance by itself. That which the Government constantly calls a "contract of accident or health insurance" *is utterly meaningless standing alone* and does not exist independently [Cf. R155-7; See pp. 20-24, *supra*, for a full discussion].

(4) The Government's interpretation completely ignores Congress' reason for carefully defining the ratio, by which to determine whether an *insurance* company is a *life* insurance company, or is a company "*other* than life" as will now be fully explained:

For many years both prior to, and since 1921, *insurance* companies—[not limited to *life* insurance companies]—have issued one or more of various kinds of insurance policies providing for (R67-69, 116-120),

(*a*) *Death* Benefits *only*—here called "*Non*-Disability" policies;

(*b*) Death *and* "Disability" Benefits ["accident and health"] *combined* in one policy—here called "Disability" policies. The Disability Benefits have always been a mere incidental part of the whole "Disability" policy (R93, 155-7).

(*c*) Accident and Health Benefits *only*—contained in an *independent, separate contract,* having no connection with life (Death Benefit) insurance; and commonly called "accident and health" insurance [Oregon Insurance Laws § 46-117 (2) *Third; Travellers Equitable Ins. Co.* 22 B. T. A. 784; *Monarch Life Ins. Co.* 38 B. T. A., 716; *Id.* 801; *Mass. Protective Ass'n. of U. S.* 114 F. (2d) 304 (C. C. A. 1st); *Com'r* v. *Monarch Life* 114 F. (2d) 314, 318-322].[18]

In 1921 [because of the peculiar nature of life insurance], Congress divided all insurance companies into three distinct and mutually exclusive "Classes", to wit:

Class I: *Life* insurance companies [whether mutual or stock companies; §§ 201-203];

Class II: *Mutual* insurance companies [*other* than *life;* § 207];

Class III: *Stock* insurance companies [*other* than *life;* § 204]

---

[18] Insurance companies also wrote:

(*d*) Other Benefits, such as Fire, Marine, Automobile, Workmen's Compensation, Credit Indemnity, Plate Glass, Burglary, Theft, etc. [In the United States, differently from England, the same insurance company rarely issues both life insurance and any of these types of insurance. Therefore, we will limit our discussion to types (1), (2) and (3) *supra.*] See Washington Insurance Law, § 83(6), 84(3).

—each class with quite different definitions of "gross" and "net" income, and with different allowable deductions.

All three "Classes" of insurance companies wrote some *separate* "accident and health" insurance. Therefore, Congress had to determine whether a company which issued *both* (1) "life insurance" policies [whether with or without the incidental Disability Benefits], *and also* (2) *separate* "accident and health" insurance policies, belonged to

> Class I; to be taxed by the method peculiarly applicable to *life* insurance with its comparatively large interest-bearing reserve funds; *or belonged to*
>
> Class II, or Class III; to be taxed by quite different methods, better adapted to other forms of insurance.

Congress determined that question by specifically *defining* a "*life* insurance" company as follows:

> "§ 201(a) DEFINITION.—When used in this title the term '*life* insurance company' means an *insurance* company engaged in the business of issuing life insurance and annuity contracts (*including contracts of combined life, health, and accident insurance*), the *reserve funds* of which *held for the fulfillment of such contracts* comprise more than 50 per centum of its total reserve funds."

This meant that *whenever* any kind of an insurance company, which however issued *both,*

(1) Life insurance policies (whether with, or without, the incidental Disability Benefits); **and, also,**

(2) *Separate* "Accident and Health" insurance,

and also held "more than 50%" of its Reserves for group (1) contracts, it was to be treated, for purposes of taxation, as a *life* insurance company, to be taxed according to a formula which was peculiarly adapted to the comparatively larger interest-bearing [19] reserve funds of life insurance and disability insurance.

It also meant that, if such a company held "*more* than 50%" of its Reserves for group (2), *i. e., separate* "Accident and Health" insurance contracts, it would not belong to Class I [even though it was incorporated as a *life* company], *but* it must be treated as a Class II or Class III company, to be taxed according to a formula better adapted to smaller, and often non-interest bearing, Reserve funds.

When "an insurance company" holds these interest-bearing Reserves in a preponderant amount, it automatically becomes a "*life* insurance company" under § 201. The reserves held for the fulfillment of (*a*) Death Benefits in "*Non*-Disability" policies and (*b*) Death *and* Disability Benefits in "Disability" policies, are the type of interest-bearing Reserve funds, on account of which, Congress in 1921 devised the new formula for the taxation of *life* insurance companies on the basis of their income from interest, dividends and rents [Class I].

A striking illustration of the perfect working of the formula in § 201(a) is found in the *Monarch Life* cases, where, *first*, for 1932, Monarch Life was held to be a Class III company—[because the "reserve funds" for *separate* accident and health policies were "*more* than 50%" of its

[19] In all life insurance [whether providing for Death Benefits only, or for both Death and Disability Benefits combined], the risks increase with the policyholder's increasing age; and yet a *level* annual premium is charged. A large part of the premium received each year is therefore set aside (*i. e.* reserved)—producing large interest bearing "reserve funds" for both Death and Disability Benefits.

(*Continued on p. 37*)

"total reserve funds"];—while, *second*, for 1933 and 1934, the *same* company was held to be a Class I company, *i. e.*, a "*life* insurance company"—[because the reserve funds for its "Disability" and "*Non*-Disability" policies were "*more* than 50%" of its "total reserve funds"]. This complete change, between 1932 and 1933, arose, because, in 1933 it enormously increased its "Disability" and "*Non*-Disability" business, in comparison with the amount of its aggregate *separate* accident and health business (Cf. *Monarch Life Ins. Co.*, 38 B. T. A. 716, and Id. 801).

IV. "Reserve funds" as used in § 201(a) includes the Reserve for Disability Benefits, as well as the Reserve for Death Benefits.

This has been fully demonstrated above (pp. 28-31, *supra*).

(*Continued from p. 36*)

On the other hand, the premiums received each year for *separate* "accident and health" insurance are ordinarily *exhausted* in covering the risks for that year. Therefore, in the case of *separate* "accident and health" insurance, reserve funds are ordinarily restricted to the comparatively small non-interest bearing "unearned premium" reserve funds [§ 204(b)(5)].

Congress taxed Class I differently from Classes II and III for the very purpose of making certain that any company which held a preponderant amount of "interest bearing" reserve funds, as contrasted with "non-interest bearing" reserve funds, would be taxed on that basis peculiarly adapted to a business inherently dependent upon its interest earnings.

SECOND POINT.

[NATURE OF "TECHNICAL INSURANCE RESERVES"]

1. In § 203(a)(2), the words "reserve funds required by law" refer to *technical insurance reserves; i. e.*, reserves held to meet a life insurance company's obligations which are entirely (a) future; (b) unaccrued; and (c) dependent upon life contingencies, or (d) dependent upon a series of life and disability contingencies.

2. For 1934, Oregon Mutual's $3,932,305.74 Reserve for "Disability" policies [including the disputed $250,861.09 Reserve for the Disability Benefits] was the *technical insurance reserve,* mathematically calculated as the then measure of its liability for the performance of only future, unaccrued, and contingent policy obligations [Death and Disability Benefits].

§ 203(a) allowed a life insurance company the following deduction, *inter alia,* from its gross income:

> "(2) RESERVE FUNDS.—An amount equal to 4 per centum of the mean of the *reserve funds required by law* and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum."

It is an undisputed fact, found by the B. T. A. and conceded in the Government's Brief, that the $250,861.09 "reserve funds" in controversy here, are "*re-*

quired by law"—and, consequently, that phrase (controverted in some cases) is not involved here (C. C. A.'s Opinion 112 F. (2d) at p. 469, 64-65, 138-9; B. T. A.'s Finding R47; Government's Brief in C. C. A., pp. 22, 24, 25, 51; Oregon Insurance Code §§ 46-137; 46-503; pp. 7, 13, *supra*).

It is also an undisputed fact, found by the B. T. A. (R46); and established in all the cases (*Pan-American* case, 38 B. T. A. at p. 1434; *Monarch Life* case, 38 B. T. A. at p. 719; 114 F. (2d) at p. 319), that Oregon Mutual's $250,861.09 Disability Reserves were maintained out of the premiums, and from the interest earned thereon (R110, Table D).

We submit;

I. *"Reserve funds" in § 203 (a)(2) mean the technical insurance reserve; i. e., the* **"actuarially calculated"** *measure of a life insurance company's liability for the performance of its* **future, unaccrued, and contingent** *obligations for Death and Disability Benefits dependent upon* **life and disability contingencies.**

Brief Summary of decided cases. "Reserve funds" as used in § 203(a)(2) has a special "technical insurance meaning." [20]

1. On the one hand, *it does not include* liabilities of the following character [20a];

(1) Unpaid bills, taxes, salaries and brokerage. (*Maryland Cas. Co.* v. *U. S.*, 251 U. S. 342, 349.)

[20] *New York Life* v. *Edwards*, 271 U. S. 109, 120; *Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, 690; *Maryland Casualty Co.* v. *U. S.*, 251 U. S. 342, 350; *Continental Assur. Co.* v. *U. S.*, [Ct. Cl.] 8 F. Supp. 474, 478; *Old Line Ins. Co.*, 13 B. T. A. 758, 761; *Minn. Mutual* v. *U. S.*, 66 Ct. Cl. 481.

[20a] Cf. Regulations, No. 77, Art. 971, pp. 273-276 as amended by Treas. Dec. 4615 XIV-2 Cum. Bull. 312 Dec. 18, 1935; No. 86, Art. 203(a)(2), p. 298; No. 94, Art. 203(a)(2), p. 369; No. 101, p. 431; No. 103, p. 473 [1940].

(2) "Reserve for depreciation," "Reserve for taxes," "Reserve for bad or doubtful debts," "Reserve for losses on bonds, stocks or mortgages"—*none of which are peculiar to the business of life insurance.* (*Helvering* v. *Inter-Mountain Life,* 294 U. S. 686, 690.)

(3) *Accrued* but unpaid death losses, which are disputed or in process of payment or adjustment. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897, 901; Cf. *McCoach* v. *Ins. Co. of N. Amer.,* 244 U. S. 585, 588, 589; *Maryland Cas. Co.* v. *U. S.,* 251 U. S. 342, 350, as modified by *U. S.* v. *Boston Ins. Co.,* 269 U. S. 197, 202-203.)

(4) Estimated death losses *accrued* December 31, but unreported. (*N. Y. Life* v. *Edwards,* 271 U. S. 109, 119).

(5) Estimated disability benefits *accrued* December 31, but unpaid. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897, 898, 901; *Equitable Life Assur. Soc.,* 33 B. T. A. 708, 712.)

(6) Deferred dividends apportioned or awaiting apportionment. (*Minn. Mutual* v. *U. S.,* 66 Ct. Cl. 481.)

(7) Annual dividends apportioned, whether due and unpaid, or not yet due. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897, 901.)

(8) Dividends left to accumulate at interest. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897; *Midland Mutual,* 19 B. T. A. 765; *Equitable Life Assur. Soc.,* 33 B. T. A. 708, 716-717.)

(9) Premiums paid in advance. (*Midland Mutual Life,* 19 B. T. A. 765, 770; *Interstate Reserve Life,* 37 B. T. A. 54.)

(10) Mortality fluctuation fund. (*Old Line Ins. Co.,* 13 B. T. A. 758, 763.)

(11) Deposit of securities required by State Insurance Departments. (*Midland National Life,* 14 B. T. A. 200; *Kaskasia Life,* 22 B. T. A. 210; *Commonwealth Life,* 31 B. T. A. 887.)

(12) Deficiency reserves as required by New York Insurance Law §85. (*North American Reassur. Co.,* 29 B. T. A. 683.)

(13) Coupons (attached to policies) matured, unsurrendered, unpaid, and left to accumulate at interest. (*Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, 689-690; *Helvering* v. *Atlas Life*, 78 F. (2d) 166; *Helvering* v. *Missouri State Life*, 78 F. (2d) 778; *Continental Assur. Co.* v. *U. S.*, 8 F. Supp. 474, 479-483 I. T. 2717, Sept. 18, 1933.)

(14) Survivorship investment funds. (*Helvering* v. *Illinois Life*, 299 U. S. 88, 90-91; *Farmers Life*, 27 B. T. A. 423; Cf. *American Central Life*, 30 B. T. A. 1182.)

2. But, on the other hand, the term "reserve funds" [used in § 203(a)(2)] means the mathematically calculated amount, which (with future net premiums to be received and compound interest thereon) will be just exactly sufficient, at any given time, to meet all **"future, unaccrued and contingent"** Death and Disability claims under then outstanding policies, if such claims arise precisely as assumed in the Tables used in the calculation.[21]

The Commissioner of Internal Revenue concedes, and always has conceded, the correctness of the foregoing definition of "reserve funds" as used in § 203(a)(2), by providing in his Regulations No. 86, p. 298; No. 94, p. 369; No. 101, p. 431 and No. 103, p. 473 [January 29, 1940] as follows:

> "Art. 203(a) (2)—**Reserve Funds**—In general, the reserve contemplated is a sum of money, variously com-

[21] Regulations No. 77, Art. 971, p. 274; No. 86, Art. 203(a)(2), p. 298; No. 94, Art. 203(a)(2), p. 369; *Equitable Life Assur. Soc.*, 33 B. T. A. 708, 713-715; *Continental Assur. Co.* v. *U. S.*, 8 F. Supp. 474, 478, 482 (Ct. Cl.); *New World Life* v. *U. S.* (Ct. Cl. R53); *Old Line Ins. Co.*, 13 B. T. A. 758, 761-763; *Fink* v. *Northwestern Mutual Life*, 267 Fed. 968, 973 (C. C. A. 7th); *Standard Life Ins. Co.*, 13 B. T. A. 13, 26-31; *Mass. Mutual Life* v. *U. S.*, 56 F. (2d) 897; *New York Life Ins. Co.*, 24 B. T. A. 1217, 1229-1230; *Interstate Reserve Life Co.*, 37 B. T. A. 54; *Monarch Life Ins. Co.*, 38 B. T. A. 716-724, 726, S. C. 114 F. (2d) 314, 319, 320, 322, 323; *Pan-American Life Ins. Co.*, 38 B. T. A. 1430, 1435; S. C. 111 F. (2d) 366, 368; *Com'r* v. *Oregon Mutual Life*, 112 F. (2d) 468, 470; *Duffy* v. *Mutual Benefit Life*, 272 U. S. 613, 618; *Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, 690; *Rhine* v. *New York Life*, 248 App. Div. 120, 124; *Rubin* v. *Metropolitan Life*, 251 App. Div. 382.

> puted or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, **future unaccrued and contingent** claims."

In short, a "technical insurance Reserve" is the amount required to fulfill an insurance company's *executory* obligations for Death and Disability Benefits, **dependent upon life and successive disability contingencies**, as such obligations shall respectively fall due in the future. This is beyond dispute. It has never been even questioned. [See authorities cited in the margin; p. 41,[21] *supra.*]

In dealing with the New York Life's technical Reserve for Disability Policies, [which contained Death Benefits and Disability Benefits in one integral life insurance policy] the Appellate Division aptly said (*Rhine* v. *New York Life,* 248 App. Div., 120, 124; s. c. 273 N. Y. 1):

> "To offset the unavoidable increase in **death and disability** rates which arise from the yearly advance in age of members insured, the company must accumulate out of premiums a fund required by law to be held by every life insurance company, and known as 'Reserve'. The amount of reserve on any policy for any given age, plan, and time in force is a matter of mathematical calculation and is exactly the same when calculated by any actuary, depending on the particular mortality table, disability table and interest rate assumed."

Throughout that Opinion, the element of disability is treated always in the same phrase with interest, mortality and expense as constituting the essential elements in the Calculation of the Premium, the calculation and maintenance of the Reserve, the accumulation of Surplus, and its distribution as Dividends to the policyholders (See 248 App. Div. at pp. 123, 124, 125, 126, 127).

II. *Oregon Mutual's $3,932,305.74 Reserve for Disability policies [including the disputed* **$250,861.09** *Reserve for the Disability Benefits] was the technical insurance reserve, mathematically calculated as the then measure of its liability for the performance of only* **future, unaccrued** *and* **contingent** *policy obligations [Death and Disability Benefits].*

I.

In 1934, Oregon Mutual had outstanding over 10,000 unmatured "Disability" policies, by each of which, Oregon Mutual had undertaken the following **future, unaccrued, and contingent obligations**, to-wit [R65; B. T. A. Findings of Facts R44-46; Opinion R47-49; Government's Brief in C. C. A. pp. 3-5, 23]:

A. Death Benefits— To pay a sum upon the *death* of the insured; *and also,*

B. Disability Benefits—To pay a specified sum to the insured, as *each successive* yearly date arrives, *provided* he is *alive* and *disabled at such date.*

Under those "Disability" policies, all held by *living* persons, Oregon Mutual's obligations [for the fulfillment of which the Reserve was $3,932,305.74] were entirely (*a*) *in the future;* (*b*) *unaccrued; and* (*c*) *contingent,* as follows:

A. Death Benefits:

[*a*] Under each of its "Disability" policies, Oregon Mutual had obligated itself to pay a definite sum upon the insured's death *in the future.*

On Dec. 31, 1934 none of these deaths had yet occurred. While some deaths would occur in the next year (1935),

and so on, others might not occur for many years to come, say 1970. On Dec. 31, 1934 the performance of the company's obligation lay wholly *in the future.*

[*b*] Since none of these deaths had occurred on Dec. 31, 1934 no payments had yet become due. Consequently, on Dec. 31, 1934, the whole of Oregon Mutual's obligation to pay such Death Benefits was still *unaccrued.*

[*c*] By the terms of these policies, no such payments were to be made by Oregon Mutual, *unless and until* the insured died. The maturity of the obligation was thus *contingent* upon the death of the insured—**a life contingency.**

There is no controversy over any Reserves for Death Benefits (whether in "Disability" or "*Non*-Disability" policies.

On the other hand, the entire controversy relates exclusively to Reserves for Disability Benefits. As will now be shown, these Reserves, precisely as Death Benefit Reserves, are solely held to meet Oregon Mutual's **future, unaccrued**, and **contingent** obligations—dependent here upon combined contingencies of death *and* disability.

B. Disability Benefits:

Active Lives: Oregon Mutual had obligated itself to pay a specified sum to the insured, as each successive yearly date arrives in the future, *provided* he is alive *and disabled at such date.* Yet, on Dec. 31, 1934 most of its 10,701 "Disability" policyholders, were "*active*", and had not suffered any disablement whatever. While some disablements might be fairly expected to occur in the next year (1935), others might not occur at all, or not for many years to come.

[*a*] Oregon Mutual's obligation for *Disability* Benefits as to these Active Lives, was thus *wholly executory;* its performance was **in the future**—as much so as its obligation to pay Death Benefits.

[*b*] Since none of these disablements had then [1934] occurred, no annual sums had then become due. Indeed, such sums might *never* have to be paid. Consequently, on Dec. 31, 1934 Oregon Mutual's entire obligation to provide Disability Benefits under those policies was still **unaccrued.**

[*c*] Furthermore, by the terms of these policies, Oregon Mutual was not bound to pay any such sums *unless the insured lived until he became disabled.* The maturity of Oregon Mutual's "disability" obligation was thus *contingent* upon the *continued* life of the insured—**a life contingency.**

But that is not all; for even if the insured should live until he became disabled, still Oregon Mutual was not bound to pay, unless, *after* his disablement, the insured *continued to live* until the first yearly date arrived; nor was it bound to pay any further sums, *unless* the insured should *further continue to live* until the successive yearly dates thereafter arrived, and be disabled at each such date.

In other words, in case of every "Disability" policy, Oregon Mutual's "disability" obligation was *contingent* upon the insured's (1) *living* until disablement, and (2), and equally important, upon his *continuing to live thereafter* until the successive yearly dates arrived—**a life contingency and also a series of disability contingencies,**[22]—for the fulfillment of which obligations, Oregon Mutual held "as required by law" its $111,127.58 Active Life Reserve in controversy (pp. 14, *supra,* 48, *infra*).

[22] *Equitable Life Ass. Soc.,* 33 B. T. A. 708, 710-711; *Com'r* v. *Oregon Mutual Life,* 112 F. (2d) 468, 470 (C. C. A. 9th); *Com'r* v. *Pan-American Life,* 111 F. (2d) 366, 368 (C. C. A. 5th); *Com'r* v. *Monarch Life,* 114 F. (2d) 314, 319, 320 (C. C. A. 1st).

Disabled Lives: A small *remainder* of its 10,701 "Disability" policyholders had, from time to time theretofore, become disabled, and were still *disabled* on Dec. 31, 1934.

As to them, Oregon Mutual had obligated itself to pay the specified sum to each disabled insured as each successive yearly date should **arrive in the future**, *but, provided always*, such insured (*a*) should *not only* **survive in the future** to the successive yearly dates on which such sums should become due, but (*b*) should continue **still to be disabled** on such future dates.

On Dec. 31, 1934 none of these dates had yet arrived. Some disabled policyholders might reasonably be expected to survive until the required dates in the next year (1935), in the next year (1936), and so on. Others would not even survive until the required date in 1935. Still others would drop out by death, from year to year, for many years to come.

[*a*] Whether or not any specific payment, or any other of such payments, would ever have to be made, depended upon,

(*a*) Whether the insured survived *in the future* to the date [some to dates in 1935 and others to dates in year to year thereafter, for many years in the future] on which such payments fell due; and

(*b*) Whether the insured should, **at such future date**, still be disabled.

On Dec. 31, 1934, none of these insured had then survived to the requisite *future* yearly dates, and no payments had then become due. The obligation was **in the future.**

[*b*] Consequently, on Dec. 31, 1934 under each of these "Disability" policies, Oregon Mutual's obligation to pay any sums (even to an insured *already* disabled) was still **unaccrued.**

[*c*] By these policies, Oregon Mutual was not obligated to pay any sum, *unless and until* the insured (already disabled) (*a*) **further survived** to the requisite successive future yearly dates, **and** (*b*) **was still disabled** on each of such future dates.

The maturity of the obligation was thus dependent upon —**a life contingency, and also a series of disability contingencies** (*Equitable Life Assur. Soc.*, 33 B. T. A. 708 at 711-716 *re* the 90% item; see note [22] p. 45, *supra*) for the fulfillment of which obligations Oregon Mutual held "as required by law" the $139,733.51 Disabled Life Reserve in controversy (pp. 2, 13, 14, 30, *supra;* p. 48, *infra*).

The amount of these **future, unaccrued and contingent** liabilities can be computed only by actuarial calculations (Oregon Mutual R67-112).

• • • • • • • •

Neither the foregoing discussion, nor any of Oregon Mutual's Reserves, relate in the slightest degree (*a*) to any Death Benefit where the insured *had died* on, or before, Dec. 31, 1934, nor (*b*) to any Disability Benefits where the yearly date had *already arrived* for the insured to receive such Disability Benefit (*Equitable Life Assur. Soc.*, 33 B. T. A. 708, at 712, 716 *re* the 10% item, p. 76 note [38], *infra*).

On the contrary, the foregoing discussion as to Disability Benefits relates solely and exclusively (1) to over 10,000 policies held, on Dec. 31, 1934, by *living* policyholders; and (2) to Disability Benefits to which the insured would not be entitled, under any circumstances whatsoever, until some **future date** *after* Dec. 31, 1934; and only *then*, conditioned upon such insured's (*a*) having **further survived**, and (*b*) having **continued disabled**, until such future date.

With respect, therefore, to its entire 10,701 "Disability" policies outstanding on Dec. 31, 1934 the whole of Oregon Mutual's obligations for Disability Benefits were **in the**

future; were **unaccrued**; and were **contingent** upon the **continued life** and **disability** of the policyholders.

This shows that its Disability Reserves (for both Active and Disabled Lives)—precisely as Death Benefit Reserves—are required by law to be held to enable Oregon Mutual certainly to fulfill its **future unaccrued and contingent** [Death *and* Disability] obligations for Disability Benefits.

II.

In 1934 [when calculated by the universally used, and admittedly correct, processes of pure mathematics R93-112; pp. 41-42 note [21], *supra*, and authorities cited therein], Oregon Mutual's Reserve [for its "Disability" policies] was (pp. 11, 13-15, 30, *supra*) $3,932,305.74:

Subdivided as follows:

1934 Reserve for "Disability" Policies

For Death Benefits		$3,681,444.65	
For Disability Benefits	Active Lives $111,127.58		
	Disabled Lives 139,733.51	250,861.09	$3,932,305.74

	Reserve		Deduction	Asserted Tax Deficiency at 13¼%
Of which	$3,932,305.74:			
Com'r *allowed* a 3¼% deduction on Death Benefit Reserve of	$3,681,444.65	or	$138,054.17	
Com'r *disallowed* a 3¼% deduction on Disability Benefit Reserve of	250,861.09	or	$9,407.29	$1,293.50
Oregon Mutual *claimed* a 3¼% deduction on its "Disability" policies' total Reserve of	$3,932,305.74			

The Commissioner was clearly wrong in *disallowing* the 3¾% deduction on the **$250,861.09** Disability Reserve.

Our apology for the repetition of these figures (pp. 2, 11-13, 30, *supra*) is simply that they show here, at a glance, that the **$250,861.09** Reserve in controversy was a part of Oregon Mutual's $3,932,305.74 total technical insurance Reserve [23] which *was* (and any *lesser* amount would *not* be) the exact mathematically calculated measure of Oregon Mutual's liability on December 31, 1934 for its **future, unaccrued and contingent** obligations to its then *living* 10,701 policyholders for their *future* Death and Disability Benefits, **none of which obligations or benefits had then become payable through either the Death, Disablement, or continued Disability, of a policyholder (R65, 126, 130-132).**

No further argument is necessary.

III.

Of Oregon Mutual's $3,932,305.74 Reserve on "Disability" policies on Dec. 31, 1934, the Commissioner properly allowed $3,681,444.65 *Death* Benefit Reserve; but he wrongfully *disallowed* $250,861.09 [24] *Disability* Benefit Reserve [part of the $3,932,305.74]. He was clearly wrong in such disallowance. The B. T. A. and C. C. A. corrected his error.

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[23] That Reserve does not measure, nor take into account, any liability whatsoever of Oregon Mutual (1) to pay any Death Claim on account of any policyholder who had *died*, or (2) to waive any *past due premium*, or (3) to pay *any past due* sum on account of any policyholder's *disability*.

[24] The Commissioner's *disallowance* of $250,861.09 Disability Reserve is the sole cause of the 1934 disputed tax liability of $1,293.50.

THIRD POINT.

[INTERPRETATION OF § 203(a)(2)]

In § 203(a)(2), the phrase "reserve funds" is not restricted to Reserve for Death Benefits only [as the Commissioner contends]; but it also includes the $250,861.09 Oregon Mutual's Active and Disabled Life Reserve for the Disability Benefits [contained in the 10,000-odd "Disability" policies], which $250,861.09 the Commissioner erroneously disallowed when calculating the 3¾% deduction.

§ 203(a)(2) provided that Oregon Mutual might *deduct* from its "gross" income,

> (2) RESERVE FUNDS—An amount equal to 4 per centum of **the mean of the reserve funds required by law** and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum.

I.

We have shown,—the B. T. A. and C. C. A. have found,—and the Government conceded—that the **$250,861.09** Active and Disabled Life Reserve for Disability Benefits,—alone in controversy here,—is, "required by law" (pp. 13, 39, *supra;* R47; 112 F. (2d) at p. 469).

It is included in Oregon Mutual's $3,932,305.74 Reserve, which is held for the fulfillment of Oregon Mutual's **future, unaccrued and contingent** obligations dependent upon life and disability contingencies; and is a *technical*

insurance reserve within the meaning of §§ 201(a), 203(a)(2) [pp. 39, 41-43, 48, 58, *supra*].

II.

The only remaining dispute is whether "reserve funds" used in § 203(a)(2), is *limited* to the reserve for *Death* Benefits only, or includes, *inter alia,* Reserve for both Death Benefits *and Disability Benefits* where "required by law" under "contracts of *combined* life, health and accident insurance" *i. e.,* "Disability" policies (R45-47; Government's Brief in C. C. A., pp. 3, 5, 24-25, 27, 28, 31).

In *Continental Assur. Co.* v. *U. S.,* 8 F. Supp. 474, [1934] the Court of Claims (LITTLETON, J.) clearly and forcefully showed that "reserve funds" as used in § 203(a)(2) *is not restricted* to Reserves for *Death* Benefits only; but that it also includes *all technical insurance reserves* held by a life insurance company to meet its **future, unaccrued and contingent** obligations for every kind of business [conducted by a "life insurance company" as defined in § 201(a)]—even though it be "reserve funds" for a type of insurance business, **such as fire or marine insurance**, not usually written by a life insurance company.

The Court of Claims there reviewed many cases; and it analyzed and clearly stated the true meaning of "reserves required by law" saying (8 F. Supp. 478):

> "In the case of life-insurance companies, the computation of the reserve, in connection with which the deduction is allowable, is to be made upon the basis of an experience table of mortality and an assumed rate of interest, the calculation of which is an actuarial function, **and the reserve intended by the taxing act as a deduction is the amount set aside from premiums and built up by interest accretions to meet existing unmatured insurance, whether fire, marine, or life insurance.**"

In the *Monarch Life* case, C. C. A. (1st) reached the same conclusion saying (114 F. (2d) at p. 323):

> "Once a company has been found to be a life insurance company under this definition [definition of § 201(a)], the type of its policies is no longer important; all its business is treated as though it were life insurance".

In support of that obviously correct determination by the Court of Claims in 1934,[25] and by C. C. A. (1st) in 1940, we further submit:

I. *No limiting words:* In § 203(a)(2), there are no limiting words to restrict the all embracing phrase "reserve funds" to any particular *type* of policy or *form* of benefit. If Congress had intended to restrict "reserve funds" to certain classes of policies or of benefits, it could easily have said so.

In the *Oregon Mutual* case, the C. C. A. (9th) aptly said (112 F. (2d) at p. 470):

> "Since the words 'reserve funds,' as used in the classification statute [§ 201(a)], embrace disability reserves held against combined life and disability policies, we see no persuasive reason to believe that they should be held to mean less than that when used in § 203(a)(2). Had Congress intended a narrower application of the term for the purpose of the deduction, **presumably it would have said so in apt language.**"

Similarly, with respect to § 203(a)(2), the C. C. A. (1st) said in the *Monarch Life* case (114 F. (2d) at p. 325):

> "If Congress had intended to limit the reserve deduction to *life* reserves **it could easily have said so.**

[25] Five years later, the Court of Claims (again LITTLETON, J.) *unconsciously* departed from that ruling in its more recent opinion in *New World Life* v. *U. S.*, 26 F. Supp. 444, 463-4 (1939) [See pp. 4, 17-24, *supra* for a critique of the *New World* case].

> In the absence of explicit language, the general meaning of the words as previously construed to apply to other than life reserves should be accepted. (*Com'r* v. *Oregon Mutual Life Ins. Co.*, 112 F. (2d) at page 470)"

The entire lack of any limitation upon the nature of the "reserve funds" [with respect to which 3¾% deduction was allowed] is quite conclusive that the words "reserve funds" cover *all* of a life insurance company's *technical insurance reserves.* "Reserve funds" must, therefore, be construed to include Reserve for *Disability* Benefits, as well as Reserve for *Death* Benefits.

2. *No differentiating words:* In the absence of any differentiation between the meaning of "reserve funds", in § 201(a), and in § 203(a)(2), Congress must have attributed **the same meaning** to those *identic words* when used in two almost successive sections. In *Pan-American Life Ins. Co.*, 38 B. T. A. 1430, 1440, the B. T. A., first, pointed out that the term "reserve funds" in § 201(a) unquestionably applied to "Disability" policies, and, then, aptly added:

> "Therefore, it would seem to follow that the term 'reserve funds' in section 203(a)(2) would also apply to 'contracts of combined life, health, and accident insurance,' which is the type of policies involved in the instant proceeding."—*i. e.*, Reserve for Disability Benefits in "Disability" policies.

Even the Court of Claims reached the same conclusion. In the case at bar (*New World Life* v. *U. S.*, 26 F. Supp. 444) the Court of Claims held that "reserve funds" in § 201(a) *meant exactly the same thing as* "reserve funds" in § 203(a)(2), saying (p. 463; New World R52),

> "we are of opinion that Congress used the term 'reserve funds' in section 203(a)(2) **in the same sense** in which it was used in section 201(a) just considered."

This is precisely correct. However, the Court of Claims completely *misconstrued* § 201(a); and consequently it gave the *same misconstruction* to § 203(a)(2). [See p. 24, *supra.*]

3. Since § 203(a)(2) permits a deduction based on reserves *"not required by law"* it would seem reasonable that the *same section* meant to allow a deduction, based on the same kind of reserves *"required by law"*.

The latter part of § 203(a)(2) provides for a different deduction, *i. e.* based on reserves *"not* required by law," to-wit:

> "(2) RESERVE FUNDS.—An amount . . . plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 3¾ per centum of the mean of such reserve funds **(not required by law)** held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of holders of such policies only;"

It is inconceivable that Congress, in enacting the 1921 and subsequent Revenue Acts, could have intended to permit some companies to take a deduction of 3¾% of certain reserves **not required by law** held for the fulfillment of a particular kind of *combined* life, health, and accident policy, and at the same time prohibit other companies from taking a 3¾% deduction of a part of the reserve specifically **required by law**, held for the fulfillment of their contracts of *"combined* life, health, and accident insurance," *i. e.*, the Disability Reserve.

Referring to this point, in the *Oregon Mutual* case C. C. A. (9th), said (112 F. (2d) at p. 470):

> "The words 'reserve funds required by law', used in the latter section, unquestionably refer to technical insurance reserves. But we think, as in § 201 (a), they comprehend reserves held to meet a life

> insurance company's obligations dependent either upon life contingencies or upon life and disability contingencies. **The provision contained in the last sentence of § 203(a)(2) tends strongly to support this view."**

Similarly, in the *Pan-American* case, C. C. A. 5th, said (111 F. (2d) at p. 368):

> "A further inconsistency in the position we are urged to take is evidenced by the provisions of Section 203(a)(2) of the Revenue Act of 1932, which expressly permits percentage deductions upon casualty reserves held by life insurance companies on certain types of policies, even though **not required by law.** It is unreasonable to believe that Congress would discriminate between companies doing the same kind of casualty business, as the interpretation would require, when the conclusion we have reached is entirely in harmony with the theory of equal benefits. Our conclusion is that the reserve for incurred disability benefits held by the taxpayer was a fund required by law within the meaning of the statute."

4. *Bureau of Internal Revenue's fourteen years' Administrative construction:* For nineteen years [1921-1939], eight successive Revenue Acts, *in identic language,*[26] authorized life insurance companies to deduct 4% [or 3¾%]

> "of the mean of the reserve funds required by law".

For fourteen years [1921-1935], the Commissioner's Regulations,[27] with respect to that deduction, expressly provided that

> "Generally speaking, the following will be considered **reserves as contemplated by the law:** Items 7-11 of

[26] § 245(a)(2) [1921, 42 Stat. 261; 1924, 43 Stat. 289; 1926, 44 Stat. 47] § 203(a)(2) [1928, 45 Stat. 843; 1932, 47 Stat. 224; 1934, 48 Stat. 732; 1936, 49 Stat. 1711; 1938, 52 Stat. 523; 1939, 53 Stat. 865].

[27] Art. 681, Regulations Nos. 62, 65, 69; Art. 971, Regulations Nos. 74, 77.

the liability page of the annual statement for life insurance companies."

Items 8 and 9 of such "annual statements" read:

Disability Reserves	
[Active Life]	"8. Extra reserve for total and permanent disability benefits . . . included in life policies . . . $_____"
[Disabled Life]	"9. Present value of amounts incurred but not yet due for total and permanent disability benefits . . . $_____"

Accordingly, for twelve years [1921-1932] the Commissioner allowed Oregon Mutual, as well as all other life insurance companies, the 4% [or 3¾%] statutory deduction for the Active Life Reserve [Line 8]; and for Disabled Life Reserve [Line 9].

See *Pan-American Life Insurance Company,* 38 B. T. A. at pp. 1436-7 for a very satisfactory discussion of this point; affirmed in *Com'r* v. *Pan-American Life,* 111 F. (2d) 366 at p. 367 (C. C. A. 5th).

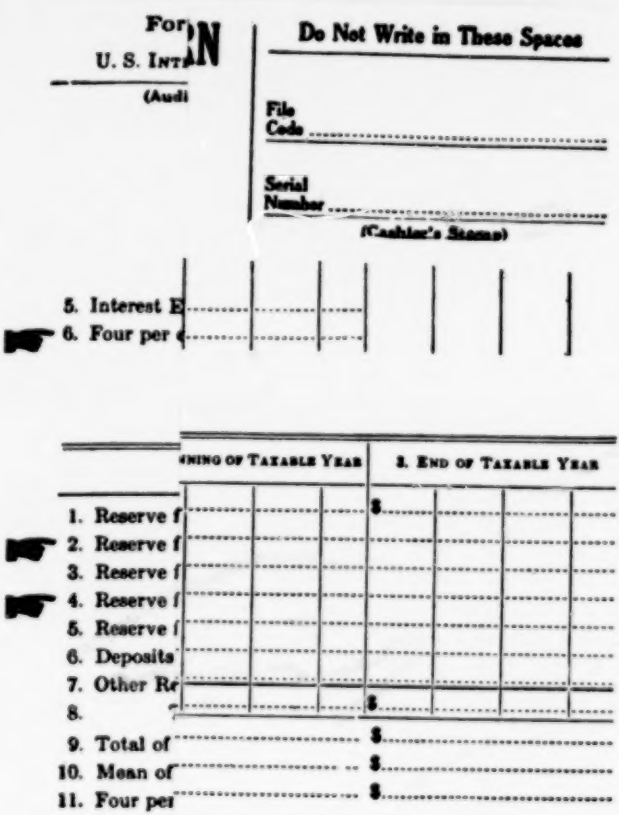
5. *Form of Income Tax Return.* During 1921-1934, U. S. Internal Revenue Form 1120L headed

> "LIFE INSURANCE COMPANY INCOME TAX RETURN for companies issuing life and annuity contracts including combined life, health and accident insurance."

expressly included "Reserve for *Disability Benefits*" as a part of

> "reserve funds required by law"

in "Schedule A—Reserve Funds" of which 4% should be deducted as follows: [Cf. Lines, 2, 4, 10, 11; "Deductions" Line 6].



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10. Mean of.....				$			
11. Four per.....				$			

In 1936, [with no change in the law which has now stood unamended [28] for nineteen years], the Commissioner disallowed all of Oregon Mutual's **$250,861.09** Active and Disabled Life Reserves for Disability Benefits, resulting in the proposed $1,293.50 tax deficiency for 1934 (R26, 41-45). The Commissioner thereby reversed himself, and departed from his own long established Regulations, and from his previously uniform administrative construction of § 203(a)(2).

[28] So far as material here.

See *Pan-American Life Insurance Company,* 38 B. T. A. at pp. 1437-8 for a discussion of the Commissioner's sudden change in his construction of § 203(a)(2); followed in *Monarch Life* case 114 F. (2d) 314 at page 323 (C. C. A., 1st); *Pan-American Life* case 111 F. (2d) 366 at pages 367-8 (C. C. A. 5th); *Oregon Mutual Life* case 112 F. (2d) 468, at 471 (C. C. A. 9th).

This very "reserve fund" deduction was the subject of long consideration and mutual discussion between Congressional Committees and the insurance companies.[29] For fifteen years, the Regulations, the Commissioner's construction of § 203(a)(2), the Income Tax blanks and the uniform administrative practice thereunder were all known to and acquiesced in by Congress, as it *re-enacted* § 203(a)(2) [formerly § 245(a)(2)] *six times without alteration.* The long established construction of the technical words "reserve funds required by law" **as including both Active Life and Disabled Life Reserves,** and the administrative practice to the same effect, should not now be overturned.[30]

6. *"Disability" Policies—a single integral insurance contract.* In excluding Oregon Mutual's $250,861.09 Disability Reserves from "reserve funds" [§ 203(a)(2)], the Commissioner denies Oregon Mutual a deduction based on a Reserve of the very kind, which, because held in sufficient amount, is the only thing which makes Oregon Mutual tax-

[29] See *National Life* v. *U. S.,* 277 U. S., at p. 523, note; *Helvering* v. *Independent Life,* 292 U. S. at p. 379; Government's Brief in *Oregon Mutual* case at pp. 10-13.

[30] *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U. S. 110, 114-115; *Mass. Mutual Life* v. *U. S.,* 288 U. S. 269, 273; *U. S.* v. *Jackson,* 280 U. S. 183, 193, 196; *Lucas* v. *American Code Co.,* Id. 445, 449; *Universal Battery Co.* v. *U. S.,* 281 U. S. 580, 583; *Fawcus Machine Co.* v. *U. S.,* 282 U. S. 375, 378; *Norwegian Nitrogen Co.* v. *U. S.,* 288 U. S. 294, 313, 315; *Alaska S.S. Co.* v. *U. S.,* 290 U. S. 256, 262; *Koshland* v. *Helvering,* 298 U. S. 441, 445; *Continental Assur. Co.* v. *U. S.,* 8 F. (Supp.) 474, 483; *Helvering* v. *Winmill,* 305 U. S. 79, 82-83.

able as a *life* insurance company. § 201(a) says that if the Reserve for the Disability Benefits contained in "Disability" policies, *plus* the Reserve for Death Benefits contained in both "Disability" and "*Non*-Disability" policies, comprise more than 50% of a company's Total Reserve funds, then that makes the company taxable as a *life* insurance company. It is inconceivable that Congress intended § 203(a)(2) to limit a company's Reserve deduction (peculiar to life insurance) to only a part of the same reserves which, because held in sufficient amount, made that company a life insurance company for tax purposes (*Oregon Mutual* case, 112 F. (2d) 468, 470 [C. C. A. 9th]).

The Commissioner improperly reaches a contrary conclusion by doing the very thing which the Courts have uniformly decided must not be done, viz., it treats a "Disability" policy of "*combined* life, health and accident insurance", *as if* there were two separate, complete, and independent contracts of insurance, to-wit:

(1) A contract of life insurance, *and also,*

(2) A contract of disability insurance;

and it deals with each, as though *the other* were non-existent.

That same argument for the *supposed* existence of two *separate* contracts of insurance has been often made and uniformly rejected (See cases collated in the margin [31]; and a full review of the leading cases at pp. 20-24, 32-34, *supra*).

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[31] *Steinberg* v. *New York Life,* 263 N. Y. 45, 1933; *Ginnell* v. *Prudential,* 205 App. Div. 495; s. c. 237 N. Y. 554; *Halperin* v. *Equitable Life,* 125 Misc. 422; *Ursaner* v. *Metropolitan,* 146 Misc. 121; *Chambers* v. *New York Life,* 148 Misc. 561; *Berg* v. *Equitable Life,* 149 Misc. 856; *Finklestein* v. *Metropolitan,* 151 Misc. 113; *Lubow* v. *Prudential,* 152 Misc. 62; *Garms* v. *Travelers,* 242 App. Div. 230; s. c. 266 N. Y. 446; *Heilbronn* v. *New York Life,* 243 App. Div. 558; *Donahue* v. *New York Life,* 259 N. Y. 98, 104; *Wittman* v. *Littlefield,* 142 Misc. 916 (Aff'd 235 App. Div. 831); *Purcell* v. *Washington Fidelity Ins. Co.* (1932) 141 Ore. 296; *Prudential Ins. Co.* v. *Litzke*

(Continued on p. 60)

The provision for Disability Benefits is only one out of various provisions in Oregon Mutual's policies (R155-7), the Reserve for which has been calculated *in solido* for the policy as a whole.[32]

By reason of the inherent nature of a "Disability" policy as a **single integral insurance contract**, with a Reserve calculated and held *in solido* for the policy as a whole, of which there can be no separation, it is impossible that Congress, in using the words "reserve funds" in § 203(a)(2), meant arbitrarily (without saying so) to split up the "reserve funds"—allowing a deduction with respect to one type of benefit [Death], and denying a deduction as to the other type of benefit [Disability].

7. The Commissioner's construction of the phrase "reserve funds" in § 203(a)(2) is absolutely **self-contradictory**:

Here, the Commissioner contends that the phrase *must be restricted* to Reserves for *Death* Benefits only; *whereas*, the Commissioner's Income Tax Return Forms expressly provide for the § 203(a)(2) deduction on "Reserve for **Annuities**"—contracts which provide *no* Death Benefits

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(*Continued from p. 59*)

(1934) 36 Del. 592, 179 Atl. 492; *Paulson* v. *Montana Life Ins. Co.*, 181 Wash. 526, 43 Pac. (2d) 971; *Baranovich* v. *Horwatt*, 113 Pa. Sup. Ct. 467, 173 Atl. 676; *Smith* v. *New York Life*,—N. C.—; *Provident Life & Acc. Co.* v. *Rimmer*, 157 Tenn. 597; *Lamar Ins. Co.* v. *Culp*, 168 Tenn. 332; *Levin* v. *Scranton Life*, 304 Pa. 92; *New York Life* v. *Doerksen*, 64 F. (2d) 240; *Smith* v. *Equitable*, 89 S. W. (2d) 165 (Tenn.); *Guardian Life* v. *Barry*, 6 N. E. (2d) 725 (Ind.).

See also: *Buffo* v. *Metropolitan*, 277 Ill. App. 366; *Grenon* v. *Metropolitan*, 161 Atl. 229 (R. I.); *Gerson* v. *Metropolitan*, 187 Atl. 194 (N. J.); *Julius* v. *Metropolitan*, 299 Ill. 343; *Henricks* v. *Metropolitan*, 61 Pac. (2d) 1162; *Richards* v. *Metropolitan*, 55 Pac. (2d) 1067.

[32] For accounting purposes, and in order to facilitate an analysis of a company's standing, the Insurance Commissioner's "Convention" blank requires that the company shall show the Reserve separately for (i) Death Benefits on all policies and (ii) Disability Benefits (sub-classified for Active and Disabled Lives)—but such classification is merely shown for statistical reasons.

whatever.[33] An annuity contract is not a life insurance contract; in fact, it is essentially the *reverse* of a life insurance contract.[34]

The Commissioner has never questioned a company's right to include **Annuity** Reserves in "reserve funds" as used in § 203(a)(2)—obviously because § 201(a) expressly provides for "reserve funds . . . held for . . . life insurance and *annuity* contracts". § 203(a)(2) refers to the *same* "reserve funds".

It is too plain for further argument that [when the Commissioner admits in his Income Tax Forms that, in § 203(a)(2), the phrase "reserve funds" include Reserves for **Annuities** (which provide *no* Death Benefits)], he cannot (merely to tax Oregon Mutual) properly contend that the *same identic phrase* in the *same identic* section, shall, in the case of the Oregon Mutual, be *suddenly restricted* to Reserve for *Death Benefits* only.

8. From 1921 to 1935, the Commissioner's Regulations and administrative practice specifically provided that "reserve funds" in § 203(a)(2) included Reserve for *all Disability* Benefits (as well as Reserve for *Death* Benefits).

On February 11, 1935, the Commissioner promulgated Regulations No. 86, which the Government now cites as its authority for *restricting* "reserve funds" to Reserve for *Death* Benefits only.

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[33] Form 1120L; IV C. C. H. 1934, p. 19203, p. 48, *supra*.

R30-4% deduction on account of American Annuitant 4% "Reserve for . . . Annuities"; Item 5 in Exhibit A, and in Exhibit B, R178, 180; Regulations No. 77, Art. 971, p. 274; No. 86, p. 298; Washington Ins. Laws §§ 83(3), 92.

[34] *Hall* v. *Metropolitan*, 146 Or. 32; *Carroll* v. *Equitable*, 9 F. Supp. 223, 224; *Cannon* v. *Nicholas*, 80 F. (2d) 934; *Commonwealth* v. *Metropolitan*, 254 Pa. 510; *Metropolitan* v. *Knapp*, 198 App. Div. 413, 415, s. c. 231 N. Y. 630; *Moskowitz* v. *Davis*, 68 F. (2d) 818; *Rishel* v. *Pac. Mut.*, 78 F. (2d) 881; *In re Thornton's Estate*, 186 Minn. 351; *State* v. *Equitable Life* (N. D.), 282 N. W. 411; *Wellman* v. *The Board of Tax Commissioners*, 252 Pac. 193; *Brownstein* v. *New York Life*, 158 Md. 51; *Cahill* v. *Maryland Life*, 90 Md. 333; *Smith* v. *Mutual Life*, 158 F. 365.

However, even Regulations 86 (like the subsequent Regulations 94, 101 and 103) do not support the Commissioner's present construction of "reserve funds". Regulations 86 (p. 298) provide that the phrase "reserve funds"

> "does not include . . . estimated value of *future premiums* which have been *waived* on policies *after* proof of total and permanent disability".

This Regulation only attempts to exclude (from "reserve funds") (i) the *Disabled* Life Reserve; and (ii) that *only* with respect to the relatively unimportant Waiver of Premium Benefit.

Regulations 86 do not attempt to exclude, directly or indirectly, (1) any *Active* Life Reserves for both Waiver of Premium and Income Benefit [$111,127.58, Table II, p. 13, *supra*], or (2) *Disabled* Life Reserves for the relatively very important Disability *Income* Benefit [principal part of $139,733.51, Table II, p. 13, *supra*].

The Commissioner's present contention that "reserve funds", as used in § 203(a)(2), are *restricted* to the Reserve for *Death* Benefits only, is thus entirely *inconsistent* with his own Regulations 86. Regulations 86 do *not* restrict "reserve funds" to Reserve for *Death* Benefits only. This is so, because they *permit the deduction* in respect to both (1) all *Active* Life *Disability* Reserves, and (2) all *Disabled* Life *Disability* Reserves for the Disability *Income* Benefit. The Disability Benefits, for which these Reserves are held, in no way involve any Death Benefits.

9. The legislative history of the 1921 Revenue Act shows that the phrase "reserve funds" in § 203(a)(2)—never changed since—was not intended to be restricted to reserves for *Death* benefits only; but, in fact, was intended to embrace *all* technical insurance reserves.

As passed by the House, the 1921 Revenue Act provided that all kinds of insurance companies should have a 4%

deduction of "reserve funds required by law", thus including every kind of technical insurance reserve (as already defined in *McCoach* v. *Ins. Co.*, 244 U. S. 585, 589; *Maryland Cas. Co.* v. *U. S.*, 251 U. S. 342), whether relating to death, accident, disability, fire, marine, plate glass, etc. As finally passed, Congress limited that deduction to *life* insurance companies only, as defined in the Act. Since the language *was not changed* from that originally applicable to *all kinds* of insurance, the phrase "reserve funds" must be construed to embrace *every kind of technical insurance reserve,* provided only it is held by a *life* insurance company. This is so, because the meaning of words, designedly including *every form* of technical insurance reserve, does not change when it is restricted to *one kind* of insurance company.

III. Review of Authorities.

Since 1921, every life insurance company has been permitted to deduct 4% of its "reserve funds required by law" (pp. 3, 55-56, *supra*).

From time to time, the Board of Tax Appeals, Court of Claims, and this Court have disallowed particular deductions upon the ground that they were based on some special reserve fund, which was not a "reserve fund" within the meaning of § 203(a)(2).[35] In so doing, those Courts have drawn a clear line of demarcation between "deductible" and "non-deductible" reserve funds [See the cases summarized in pp. 39-41, *supra*].

In those cases, the Courts have precisely defined "reserve funds", as used in § 203(a)(2), to mean the mathematically calculated sum (1) directly pertaining to insurance risks, and (2) necessary to meet the company's future, unaccrued, and contingent obligations, which are

[35] § 245(a)(2) in earlier Acts [see p. 2, note [2]; p. 55 note [26], *supra*].

dependent upon **life and disability contingencies.** (See pp. 41 note [21], 42-48, *supra*, and cases there cited.)

To narrow that definition now so as to exclude *Disability* Reserves would emasculate and wreck the uniform construction and administration of every Revenue Act since 1909.

• • • • • • • • • • •

In the several B. T. A. and C. C. A. (1st, 5th and 9th) cases now to be reviewed, the Courts have carefully pointed out the *exact equivalence* in the character of the Reserves, although called by different names. The following Table shows such equivalence—in terms of Active Life Reserves and Disabled Life Reserves, which are the terms used by New World:

	Nature of Policies and Reserves			
Company	"*Separate* accident and health"		"*Combined* life, health and accident insurance" [§ 201(a)]	
	Active Life	**Disabled Life**	**Active Life**	**Disabled Li**
Equitable [33 B. T. A. 708]	"Additional reserve on non-cancellable accident and health policies" (p. 710)	"Reserve for unpaid and unresisted claims" (pp. 711, 716)	None	None
Monarch [38 B. T. A. 716] 114 F. (2d) 314	"Additional reserve on non-cancellable accident and health policies" (pp. 720, 724; 321)	"Reserve for unpaid and unresisted claims" (pp. 721, 724; 322)	None	"Reserve for curred disab benefits" (pp. 718, 72 320)
Pan-American [38 B. T. A. 1430] 111 F. (2d) 366	None	None		"Reserve for curred disab benefits" (pp. 143 1436-9, 36
Oregon Mutual [39 B. T. A. 1239] 112 F. (2d) 468	None	None	"Active Life Reserves" (112 F. (2d) 469	"Disabled L Reserve (112 F. (2d
New World [26 F. Supp. 444]	None	None	"Active Life Reserves" (R47)	"Disabled L Reserves (R47)

***Oregon Mutual Life Insurance Co., 39 B. T. A. 1239; 112 F. (2d) 468* [*C. C. A. 9th*].**

In 1934, Oregon Mutual had over 10,000 "Disability" policies, with Reserves as follows:

				Reserve
1934 Disability Policies	Death Benefits			$3,681,444.65
	Disability Benefits	Active Lives	$111,127.58	
		Disabled Lives	139,733.51	250,861.09
			Total Reserve	$3,932,305.74

The controversy arose as follows:

1934 "DISABILITY" POLICIES

Oregon Mutual contended "Reserve Funds" were...	$3,932,305.74
Com'r contended "Reserve Funds" were for *Death* Benefits only	3,681,444.65
Com'r excluded Reserve for *Disability* Benefits.....	$ 250,861.09
Com'r disallowed deduction of 3¼% [§ 203(a)(2)]	$ 9,407.29
Com'r asserted tax deficiency of 13¼% of $9,407.29	$ 1,293.50

B. T. A. held that the Commissioner was wrong; that Oregon Mutual was right; and that "reserve funds" in § 203(a)(2) included all the technical reserve on "Disability" policies, *i. e.*, not only (1) the Reserve for *Death* Benefits; but also (2) Reserve for *Disability* Benefits, as computed for (*a*) *Active* Lives, and (*b*) *Disabled* Lives, saying (R47-48):

> "The reserves here in issue are additional reserves set up under the policies containing disability provisions *to meet future unaccrued and contingent liabilities* under those provisions. These reserves are in all essentials like those involved in *Equitable Life Assurance Society*, 33 B. T. A. 708, and which we there held met the statutory description of 'reserve funds required by law.' One of the reserves in the *Equitable* case was called 'additional reserve on noncancellable accident and health policies.' That reserve is like the one here called the '*active life reserve*,' and was maintained, in both cases, *to meet*

> *anticipated but unaccrued claims under those policies where the insured had not incurred disability within the year.* The other reserve in the *Equitable* case, called 'reserve for unpaid and unresisted accident and health claims' is like the one this petitioner calls its '*disabled* life reserve.' *This reserve was maintained in both cases to provide for the payment of benefits expected to arise in the future from disabilities already incurred by policyholders.*"

B. T. A., *first,* sustained the deduction based on *Active* Life Reserves, upon the authority of the *Equitable Life* and *Monarch Life* cases [33 B. T. A. 708; 38 B. T. A. 716]. *Secondly,* it sustained the deduction based on the *Disabled* Life Reserve upon the authority of the *Pan-American Life* case [38 B. T. A. 1430] saying (R49):

> "That reserve [*Pan-American Life* case] is identical with the one that this petitioner calls a disabled life reserve. The policies involved in the *Pan-American* case, as here, were life insurance policies containing provisions for disability benefits. The reserves there, as here, were carried to enable the company to pay benefits in cases *where disabilities had occurred* but where the benefits were *not* then payable . . . we hold the petitioner [Oregon Mutual] entitled to deductions based on its active and disabled life reserves carried under the disability provisions of its life insurance policies."

The C. C. A. (9th) *affirmed* that decision in *Commissioner* v. *Oregon Mutual Life,* 112 F. (2d) 468, saying:

> "Since the words 'reserve funds,' as used in the classification statute, embrace disability reserves held against *combined* life and disability policies, we see no persuasive reason to believe that they should be held to mean *less than that* when used in § 203(a)(2). **Had Congress intended a narrower application of the term for the purpose of the deduction, presumably it would have said so in apt language.** The words 'reserve funds required by law,' used in the latter section, unquestionably refer to technical insurance re-

serves. But we think, as in § 201(a), they comprehend reserves held to meet a life insurance company's obligations **dependent either upon life contingencies or upon life and disability contingencies."**

***Monarch Life Ins. Co.*, 38 B. T. A. 716: 114 F. (2d) 314 [C. C. A. 1st].**

In *Monarch Life Insurance Co.* 38 B. T. A. 716, Monarch Life issued **(1)** "*Non*-Disability" policies, and "Disability" policies, *i. e.*, policies of "*combined* life, health and accident insurance", and also **[2]** [*differently* from Oregon Mutual], *separate* policies of accident and health insurance (both cancellable and non-cancellable).

Monarch Life's Reserve under its "Disability" and "*Non*-Disability" policies was "more than 50%" of its "total Reserve funds" [for "Disability", "*Non*-Disability", and *separate* "accident and health insurance" policies]. Therefore, it was taxable as a "*life* insurance company"[36] under § 201(a).

I. Disabled Life Reserve *under policies of "combined life, health and accident insurance."* Monarch Life deducted 3¾% of its Reserve for Waiver of Premium Disability Benefits, with respect to policyholders already disabled. The Commissioner contested this. The B. T. A. held that "reserve funds" under § 203(a)(2) was *not* restricted to Reserve for Death Benefits only, but included this Disabled Life Reserve, saying (38 B. T. A. 718, 724-5):

> "Hence, this fund was designed to cover **future** claims that were **unaccrued and contingent**, since the claims accrued only as the total disability continued and there was no way of ascertaining in a given case how long the disability would in fact continue. In our opinion, petitioner's reserve fund for incurred

[36] In this case, it was a "life insurance company" [Class I], although in previous years it was not a *"life"* insurance company, but was a stock insurance company *other* than life [Class III] (See pp. 34-37, *supra*).

disability benefits comes squarely within the statute under the interpreting decisions above referred to, and we hold that respondent erred in disallowing the deduction claimed."

II. Active and Disabled Life Reserves, *under separate "accident and health" policies.*

Active Life Reserves — *Additional reserve on* [separate] *non-cancellable accident and health policies.*

Disabled Life Reserves — *Reserve for unpaid and unresisted claims.* [Un-accrued]

These Reserves [which were identical with those dealt with in the *Equitable Life* case, pp. 64; 75-77, *infra*] were exactly like Oregon Mutual's *Active* Life Reserves and *Disabled* Life Reserves, *except* that in the case of the Monarch Life, the reserves were held for *separate* "accident and health" insurance with *no element* of life insurance therein, *whereas,* Oregon Mutual's Active and Disabled Life Reserves were both held solely for the fulfillment of "*combined* life, health and accident insurance" policies.

The B. T. A. held that Monarch Life was entitled to the 3¾% deduction on both its Active Life Reserves and its Disabled Life Reserves saying (p. 724):

> "Two of the reserve funds involved herein, viz., the additional reserve on noncancelable accident and health policies [Active Life Reserve] and the reserve for unpaid and unresisted accident and health claims [Disabled Life Reserves] were considered by this Board in *Equitable Life Assurance Society of the United States,* 33 B. T. A. 708, and there held to be reserves required by law within the meaning of the Revenue Acts of 1924 and 1926, which contain provisions similar to the 1932 and 1934 Acts. Accord-

> ingly, in so far as the deficiencies result from the denial of deductions computed on the basis of the two reserve funds just mentioned, respondent's action is reversed and we hold for petitioner on authority of the cited decision."

In response to the Commissioner's contention that "reserve funds" in § 203(a)(2) extend "*only* in respect of reserves maintained for *death benefits* under *life* insurance policies"—which is the precise contention which the Commissioner makes here—the B. T. A. rejected that contention saying (p. 726):

> "This is a novel proposition, and we have been unable to find any authority to support it. Section 201 (a) of the Revenue Acts of 1932 and 1934, relating to the tax on life insurance companies, defines the term 'life insurance company' as meaning 'an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.' The parties to these proceedings have stipulated that more than 50 percent of petitioner's total reserve funds held during the taxable years were held for the fulfillment of life insurance contracts, and that petitioner was held to be taxable as a life insurance company. **If petitioner is taxable as a life insurance company, it must follow that its reserve funds must be treated as reserve funds of a life insurance company.** *Equitable Life Assurance Society, supra,* dealt with reserves on accident and health policies, such as are involved in the present proceedings, and they were there held to be a proper basis for allowable deductions. Respondent's position on this point, we think, can not be sustained, and his action is reversed."

This was *affirmed* in *Com'r* v. *Monarch Life,* 114 F. (2d) 314; where, with reference to the Disabled Life Reserves

for policies of "combined life, health, and accident insurance", the C. C. A. (1st) said:

> "The Commissioner contends that this is not a technical insurance reserve because, he says, it is maintained to pay claims which have already accrued or matured. The reserve is set up to insure against the continuance of the total disability by providing a fund to supply the premiums to be waived during the continuance of the disability. In order to receive the benefit of the waiver, the insured must be alive and totally disabled at the time a premium becomes due; and the waiver is contingent upon fulfillment of these conditions.
>
> The claim is not accrued because, though the disability has been incurred, the continuance of the disability is uncertain, and thus the waiver is contingent. The extent of the probable liability and the amount of the reserve created are fixed by reference to mortality and disability tables plus an assumed interest rate. When the premium becomes due and total disability exists, the premium is paid out of the reserve and is no longer a part of the reserve. It is clear that the reserve is held by the taxpayer against claims of insurance that are 'future', 'unaccrued', and 'contingent'. It is a true technical insurance reserve. *Commissioner* v. *Oregon Mutual Life Insurance Co.* (9 Cir., 1940), 112 F. 2d 468; *Commissioner* v. *Pan-American Life Insurance Co.* (5 Cir., 1940), 111 F. 2d 366; cf. *Equitable Life Assurance Society* v. *Com. of Int. Rev.* (1935), 33 B. T. A. 708. . . ."

Furthermore, with reference to all Reserves in controversy, including both Active and Disabled Life Reserves for *separate* accident and health policies, the C. C. A. (1st) also said:

> "It is stipulated that the reserve funds in the instant case were computed upon the basis of experience or actuarial tables; that an interest assumption was involved; and that the reserves were set up and maintained out of premiums. Though the stipulated

> facts in regard to the additional reserve for noncancellable health and accident policies are slightly ambiguous on these points, it is clear that the reserve is set up from premiums and based on experience tables with an assumed rate of interest. See *Massachusetts Protective Association, Inc.* v. *United States*, 1 Cir., August 6, 1940, 114 F. (2d) 304.
>
> All that remains to make these reserve funds technical insurance reserves is to show that they directly pertain to insurance, and were set aside and maintained for the purpose of maturing and liquidating either by payment or reinsurance with other companies, future, unaccrued and contingent claims. . . .
>
> The reserves in question fulfill all the requirements of the various definitions of a technical insurance reserve fund required by law. They also comply with the general definition set forth in Regulations 86, Section 203(a)(2)-1 (1935)."

A fortiori, this C. C. A. decision should control as to Oregon Mutual's $250,861.09 Reserves for Disability Benefits, because a large part of Monarch Life's policies were **separate** accident and health insurance, whereas Oregon Mutual's policies were contracts of **combined life, health, and accident insurance** (R93, 155-7; p. 11, *supra*).

***Pan-American Life*, 38 B. T. A. 1430: 111 F. (2d) 366 [C. C. A. 5th].**

In *Pan-American Life Insurance Co.*, 38 B. T. A. 1430, Pan-American (like Oregon Mutual) issued nothing but "*Non*-Disability" and "Disability" policies, *i. e.* "contracts of *combined* life, health and accident insurance". Only *Disabled* Life Reserves were involved.

The B. T. A. thus described the reserve funds in controversy (p. 1435):

> "To meet its **future unaccrued and contingent obligations** under these *combined* life, health, and accident policies, petitioner set up and held at the beginning

> and end of the taxable year several reserve funds . . . The fourth reserve, which is the one here involved, was set up by petitioner and held to meet its **future unaccrued and contingent obligation** to waive premiums or to waive premiums and to pay a monthly income, depending upon the type of policy, in cases of total and permanent disability where the insured had already become disabled."

Disabled Life Reserves. The B. T. A. held that Pan-American's Disabled Life Reserve [just described] was included in the phrase "reserve funds" [§ 203(a)(2)] [*a*]. With respect to the Waiver of Premium Disability Benefit it said (pp. 1438-9):

> " . . . the question at issue, at least as far as *premium waiver benefits* are concerned, is identically the same as the issue relating to the reserve for incurred disability benefits [Disabled Life Reserves] in the recent case of *Monarch Life Insurance Co.*, 38 B. T. A. 716. In that case we held that the reserve for incurred disability benefits (apparently involving *premium waiver benefits only*) was a reserve fund required by law and that the petitioner there was entitled to deduct from its gross income an amount equal to 3¾ per centum of the mean of such a reserve fund held at the beginning and end of the taxable year. It follows that, at least as far as *premium waiver benefits* are concerned, the instant proceeding is controlled by our holding in *Monarch Life Insurance Co., supra.* Cf. *Equitable Life Assurance Society of the United States* (reserve for unpaid and unresisted accident and health claims), 33 B. T. A. 708, 711" [See pp. 67-71, *supra,* pp. 75-77, *infra*].

With respect to the Income Disability Benefit, the B. T. A. said (p. 1439):

> "Regarding that portion of the reserve for incurred disability benefits [*Disabled* Life Reserve]

involving monthly *income* benefits, we know of no reason why it should be treated any differently from that portion of the reserve involving premium waiver benefits. The policies involving both kinds of benefits are substantially the same, except that in those involving both *premium waiver* and *monthly income* benefits the insured agrees to pay a larger additional premium than the insured pays in those policies involving premium waiver benefits only. We hold that both portions of the reserve for incurred disability benefits [*Disabled* Life Reserve] involved herein should be treated alike and that petitioner is entitled to deduct from its gross income the amount of $12,940.62 set out in our findings as representing 3¾ per centum of the mean of the reserve for incurred disability benefits held at the beginning and end of the taxable year."

The B. T. A. aptly answered the Commissioner's contention here that "reserve funds" in §203(a)(2) were *limited* to the Reserve for *Death* Benefits only in *life* insurance, saying (p. 1440):

"Neither do we think the Supreme Court in the *Inter-Mountain* and *Illinois Life* cases intended to construe the phrase 'reserve funds required by law' to mean only the reserve funds relating to *life* insurance. It seems to us that the structure of the act requires a recognition of other reserves. Sec. 201(a), *supra*, defines the term 'life insurance company' as one 'engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.' In this definition there can be no doubt but that Congress intended the term 'reserve funds' to apply to 'contracts of *combined* life, health, and accident insurance' as well as to 'life insurance and annuity contracts'. Therefore, it would seem to follow that the term 'reserve funds' in section 203(a)(2) would also apply to 'contracts of *combined* life, health,

and accident insurance', which is the type of policies involved in the instant proceeding. Any other construction of the act would be inconsistent with the respondent's allowance of the statutory per centum of the mean of the reserve for disability and accidental death benefits reported on line 2 of Schedule A of the return and briefly referred to at the beginning of this opinion. The only difference between that reserve [Active Life Reserve] and the one for incurred disability benefits [Disabled Life Reserve] is that in the latter the disability has *already* taken place. **But the insured must survive and remain disabled on each and every anniversary date of the policy before any actual liability accrues against petitioner."**

The C. C. A. (5th) *affirmed* the B. T. A., saying (*Com'r* v. *Pan-American Life* 111 F. (2d) 366):

"The nature of the reserve in dispute [Disabled Life Reserve] is persuasive to the conclusion we have reached. Incurred disability reserves were created only after the disability had arisen. They were *not* fixed obligations. They were payable only *in the future,* and were *contingent* upon the continuance of both life and disability. Not being completely accrued, the extent of the probable liability thereunder was computed, and the amount of the reserve created was fixed, by tables of probability based upon approved rates of termination of such liability. The method of computation so employed is wholly consistent with that used for establishing amounts of premiums and reserves for ordinary life-insurance and annuity contracts, and is wholly inconsistent with reserves created to defray accrued and definite liabilities payable in the future. This is the distinguishing feature between the case at bar and those relied upon by the Commissioner, which dealt with reserves for payment of accrued obligations for fixed amounts created by contract. The latter are mere solvency reserves having no relation to true insurance risks."

***Equitable Life Assur. Society*, 33 B. T. A. 708.**

In *Equitable Life Assur. Society*, 33 B. T. A. 708, Equitable Life issued *separate* policies of non-cancellable "accident and health" insurance.

[**Active Life Reserves.**] In order to meet its future, unaccrued and contingent obligation to pay sums to those of its healthy *Active* policyholders, who might, *in the future*, unfortunately become disabled, Equitable maintained a Reserve (there called "Additional Reserve on Non-Cancellable Policies"; called in the case at bar "*Active* Life Reserves", p. 64, *supra;* Item 8, p. 56, *supra*).

The Commissioner stipulated in that Record, and *conceded in his Brief*[37] that such Reserve was

> "computed upon the same actuarial principles as the reserve described . . . in item 8 of the liability page of the Life Statement"; [and was] "includible in the reserve funds required by law to be used in determining the deduction of '4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year.' "

The B. T. A. held that such "Additional Reserve on Non-Cancellable Policies", ["*Active* Life Reserves"] was included in the phrase "reserve funds" in § 203(a)(2), saying (p. 711):

> "Believing this *concession* to be proper and in line with the decisions in [citing 9 authorities], we deem it unnecessary to pursue the question further."

We thus see that in the *Equitable* case, the Commissioner stipulated and conceded—and the B. T. A. approved and held—that the technical insurance Reserve held by the Equitable Life for the performance of its **future, unaccrued**

[37] Paragraph XV, Agreed Statement of Facts, Dockets Nos. 31110, 33241 and 57867; 33 B. T. A., p. 711.

and contingent obligations to its policyholders in the event of **disability** [*Active* Life Reserves] was included in "reserve funds" in § 203(a) (2). This should be decisive as to Oregon Mutual's $111,127.58 *Active* Life Reserve (pp. 30, 44-45, 56, *supra*).

[**Disabled Life Reserves.**] Equitable Life's *Disabled* Life Reserve was held for the fulfillment of the weekly benefits which it might have to pay, *in the future*, to policyholders *already* disabled, *i. e.*, on account of disabilities which had *already commenced* (Disabled Lives), but where the disabled policyholders might, or might not, continue to live from week to week, to the successive weekly dates on which such disability benefits respectively became payable in the future (33 B. T. A. at pp. 711-712).

Ninety per cent (90%) [38] of the *Disabled Life Reserve* [ranging for the years in question from $350,000 to $1,500,000, 33 B. T. A. at p. 713, Table; p. 716] was

> "for the payment of benefits which will become due in the future, *if* the policyholders survive and remain disabled."

In respect of that 90% Reserve, the Commissioner stipulated: [39]

> "For both cancellable and non-cancellable policies this reserve is held for the same purpose as reserve item 9 of the Life Statement form [New World's *Disabled* Life Reserve.] For non-cancellable policies

[38] The other 10% of that Reserve was "held for the payment of benefits which *have accrued* and *are unpaid*, in respect to disabilities which *have already commenced*" Equitable Life conceded, and B. T. A. properly held that such 10% was *not* included in the term "reserve funds required by law" within the meaning of § 203(a)(2) [or its identic predecessor, § 245(a)(2); 33 B. T. A. at p. 712] because the weekly benefits in question [for which such 10% was held] had *already accrued and were unpaid*; and such claims fell squarely within the items (3)-(5) summarized at p. 26, *supra*. **New World has never claimed any deduction of that character.**

[39] Paragraph XVI, Agreed Statement of Facts, Dockets Nos. 33241 and 57867.

this second element of the reserve since January 1, 1926, has been calculated in the same manner as item 9 of the Life Statement form." [Oregon Mutual's *Disabled* Life Reserve.]

The B. T. A. held that such 90% Reserve was included in "reserve funds" [§ 203(a) (2).] This 90% Reserve was exactly the same thing that Oregon Mutual calls its Disabled Life Reserve (p. 64, *supra*).

A fortiori, this B. T. A. decision should control as to Oregon Mutual's $139,733.51 Disabled Life Reserve, because the Equitable Life's policies were *separate* accident and health insurance, *whereas* Oregon Mutual's policies were "contracts of *combined* life, health and accident insurance" (pp. 11, 13-14, 30, 46, 47, *supra*).

IV. Commissioner's Authorities Distinguished.

The Commissioner relies on *Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, and *Helvering* v. *Illinois Life*, 299 U. S. 88, *first*, as justifying the Commissioner's attempted retroactive Regulations 86, p. 298 (p. 62, *supra*); and, *secondly*, to support his action contrary to Regulations 86 [p. 62, *supra*] in limiting Oregon Mutual's 3¾% deduction to "reserve funds" for *Death* Benefits only (New World R. 52, 53, 57).[40]

Neither the *Inter-Mountain* case nor the *Illinois Life* case supports the Commissioner's contention.

These two cases will now be analyzed.

1. Helvering v. Inter-Mountain Life, 294 U. S. 686: Attached to the life insurance policies were a series of annual coupons, by which Inter-Mountain Life agreed (1) to pay the policyholder, at maturity each year, the amount

[40] *New York Life* v. *Edwards*, 271 U. S. 109, is reviewed at p. 83, *infra*.

of the coupon, or (2) at the insured's option, to hold the amount of the coupon at interest,—payable on demand, or at death, or convertible into insurance or annuity. The laws of Utah required a reserve necessary to cover that coupon liability.

Inter-Mountain Life "carried a separate [$136,523.39] reserve against matured, unsurrendered and unpaid coupons". The question involved was whether "reserve funds" in § 203(a)(2) embraced that $136,523.39.

That $136,523.39 "separate reserve" measured the company's liability for *present, unpaid, matured, accrued* and *non*-contingent "coupon" obligations, the payment of which had to be made at any time on demand, and which was wholly independent of any life contingency whatsoever.

This Court emphasized that the "liability on the matured coupons, depends upon *no contingency*" (p. 690). They were like *unpaid* death losses or *unpaid* dividends (p. 40, Items 3, 8, *supra*). They were *solvency* reserves, *with no relation to insurances;* **whereas**, Oregon Mutual's reserves, pertained directly to *life* insurance, and had *no characteristics* of so-called "solvency reserves".

The B. T. A. aptly said, *Pan-American* case, 38 B. T. A. 1439-1440:

> "The reserve funds involved in the other two cases [*Inter-Mountain Life* and *Illinois Life*] were in the nature of solvency reserves and were essentially different from the one which we are now considering. For instance, the reserve in the *Inter-Mountain* case, supra, was against matured, unsurrendered, unpaid coupons, and was *not* essentially an *insurance* reserve. Inter-Mountain's liability thereon depended upon no contingency. The insured there at any time could have withdrawn the matured coupons in cash. . . . Neither do we think the Supreme Court in the *Inter-Mountain* and *Illinois Life* cases intended to construe the phrase 'reserve funds required by law' to mean only the reserve funds relating to *life* insur-

ance. It seems to us that the structure of the act requires a recognition of other reserves."

Oregon Mutual's **$250,861.09** Disability Reserves [Active and Disabled] were entirely different, in that they were the mathematically calculated measure of its liability for **future, unaccrued and contingent** policy obligations to pay Disability Benefits. **These obligations were entirely in the future; they had not yet accrued; and their payment was dependent upon life and disability contingencies.**

This Court's reference to "life insurance" and "life insurance elements" and "life reserve" was simply because the policies in question were "Non-Disability" policies; and since the policies had no Disability Benefits, the Court was only concerned with Death Benefits, ordinarily called life insurance.

2. Helvering v. Illinois Life Ins. Co., 299 U. S. 88: The policies provided that, out of each year's premium (after the first), a certain sum should be set aside for a "survivorship investment fund", to be invested at 3½% compound interest; and, at the end of twenty years, the fund should be divided among the persistent survivors of the "group". The "survivorship investment fund" was $3,343,982.67,—4% of which was deducted under § 203(a)(2).

Following the *Inter-Mountain Life* case, this Court rejected the deduction, and held that "reserve funds" in § 203(a)(2) did not embrace the $3,343,982.67 "survivorship investment fund".

While Illinois Life had a future and unaccrued obligation to apportion the "survivorship investment fund" among a group of policyholders at a future date, yet that obligation lacked the essential element of "reserve funds" in that such obligation **did not in the slightest degree depend upon any life, disability, or other contingency.** Illinois

Life's obligation was *an unconditional and non-contingent obligation, i. e.,* to pay the specified sum which each policyholder had paid into the fund *plus* a fixed rate of interest thereon; and Illinois Life's obligation to pay whatever aggregate amount was paid in by policyholders *plus* a fixed interest rate thereon, **did not depend upon whether any one or more policyholders lived or died.**

Consequently, the *liability* to pay the fund **was not dependent upon a life or disability contingency.** This Court thus aptly expressed that idea saying (p. 90):

> "Under these policies the company's liabilities on account of the investment funds are **independent** of those attributable to life insurance risks. The right to participate in the investment funds **is not dependent upon death of the insured.** The company's liability is the total of contributions to the fund plus the interest agreed to be paid. It is bound to discharge this liability at the end of 20 years. • • • The survivorship investment fund feature of these policies has no relation to life insurance risks."

Illinois Life's "survivorship investment fund" had no element either of *insurance,* or of *risk.* That is where it differs from Oregon Mutual's **$250,861.09** Disability Reserve which measures the liability for an *insurance* obligation *dependent upon life and disability contingencies.*

Illinois Life's policies were "*Non*-Disability" policies; and hence, as in the *Inter-Mountain Life* case, this Court's references to "*life* insurance", "*life* insurance risks" and "*life* insurance liability" were because the policies in question *were* ordinary *life* insurance policies with Death Benefits only; and there was no occasion for this Court to refer to the *future, unaccrued* and *contingent* disability obligations under "Disability" policies.

The B. T. A. acutely remarked (38 B. T. A. 1440):

> "Likewise, in the *Illinois Life* case, *supra,* the reserve for survivorship investment funds was *not*

a reserve set aside to mature or liquidate any future unaccrued and contingent claims. Illinois Life was bound at the end of 20 years to discharge a definite liability consisting of the total contributions to the fund plus the interest it had agreed to pay. The reserve set up to meet this definite liability was in substance nothing more than a solvency reserve."

In the *Monarch Life* case, the C. C. A. (1st) also distinguished the *Illinois Life* and *Inter-Mountain Life* cases, saying (114 F. (2d) at p. 325):

> "While certain language in *Helvering* v. *Illinois Life Insurance Co.*, supra, appears to sustain the Commissioner's contention that the reserves must be technical life insurance reserves, an examination of all the cases shows that this is not true. 'The language used in an opinion must be read in the light of the issues presented.' *Sinclair* v. *United States*, 279 U. S. 749, 767. In the *Illinois Life Insurance Co.* case, as in *Helvering* v. *Inter-Mountain Life Insurance Co.*, and *Continental Assurance Co.* v. *United States*, supra, also relied on by the Commissioner, the court distinguished between life insurance reserves and 'solvency' reserves. There was no question of drawing any line between life insurance reserves and other true insurance reserves. The only reserves to which the language could refer in all three cases were life insurance reserves. The question here presented was not in any manner raised. The *Illinois* case expressly approved the *Inter-Mountain* decision where the court said that reserves cannot "include values that do not directly pertain to insurance" (294 U. S. 686, 690) with no words restricting the language to "life" insurance. And the *Inter-Mountain* case approved the holding of the Court of Claims in the *Continental Assurance Co.*, supra, decision that "the reserve intended by the taxing act as a deduction is the amount set aside from premiums and built up by interest accretions to meet existing unmatured insurance, whether fire, marine, or life insurance" 8 F. Supp. 474, 478. The reserves in question here

come completely within this definition, and it is our opinion that *Helvering* v. *Illinois Life Insurance Co.*, supra, intended in no way to limit this definition. *Commissioner* v. *Oregon Mutual Life Insurance Co.*, supra; *Pan-American Life Insurance Co.* v. *Comm. of Int. Rev.*, 1938, 38 B. T. A., 1430, 1438, affirmed, 5 Cir., 1940, 111 F. 2d 366."

3. In the *Inter-Mountain* and *Illinois Life* cases, this Court had no thought of confining "reserve funds" to *Death* Benefits only, because,

(*a*) § 201(a) explicitly *includes* reserve for Disability Benefits, in the "reserve funds" with which §§ 201-203 deal (pp. 28-30, *supra;* 38 B. T. A. 726; *Id.* 1440).

(*b*) "Reserve funds" embraces reserves for **Disability** Benefits for the very purpose of *defining* a *"life* insurance company" **so as to render it taxable.** Therefore, "reserve funds" in §203 must also embrace reserves for the same **Disability** Benefits, when used in fixing the *amount* of the tax imposed by those same words in § 201 (*Id.*).

Obviously, neither Congress nor this Court intended that the *same words* should have one meaning in § 201 in order to make the company taxable at all, and a *different* meaning in § 203, in fixing the *amount* of the tax imposed by the *same words.*

(*c*) "Reserve funds" has been recognized as embracing reserves for Disability Benefits (1) in every Revenue Act since 1909, (2) in all the Regulations promulgated thereunder, and (3) in the Commissioner's administrative practice,—until the Commissioner suddenly changed his mind in 1936 (Cf. 38 B. T. A. 1436-8, pp. 55-56, 60-62, *supra,* for a discussion of this subject).

(*d*) To so hold, would compel life insurance companies to pay taxes upon the whole of its interest earnings on its Disability Reserves, the greater part of which

interest is required to maintain the Reserve which the company is required by law to hold as Reserve to meet their *future, unaccrued* and *contingent* obligations for Disability Benefits. Such a holding would destroy the whole basis for taxation under the 1921 and subsequent Acts.

(*e*) This Court certainly did not intend that a few expressions which it *correctly used* in the *Inter-Mountain* and *Illinois Life Cases* [with reference to the particular kind of insurance involved in thoses cases, (*i. e.* life insurance with *Death* Benefits only)], should be wrenched from the context, and applied (as the Government urges) to entirely different *kinds* of policies **not involved in those cases;**[41] especially as this Court has suggested more than once that "reserve funds" as used in the Federal taxing Acts must be construed so as to cover varying situations which arise for one company in *one kind of business,* not present in some other company with a *different* kind of business. (*U. S.* v. *Boston Ins. Co.*, 269 U. S. 197, 203.)

New York Life v. *Edwards,* 271 U. S. 109, is not in conflict with Oregon Mutual's contention, because the questions there involved were entirely different from those involved here.

4. New York Life v. Edwards, 271 U. S. 109. The 1913 Revenue Act permitted New York Life to deduct *"the net addition,* if any, *required by law* to be made within the year *to reserve funds".*

New York Life's 1913 Annual Statement [made on the Superintendent of Insurance's official blank] duly reported its Reserve (Items 1-7) and its other Liabilities (Items 9-47). It included its Disabled Life Reserve as a *specially*

[41] *Webster* v. *Fall,* 266 U. S. 507, 511; *U. S.* v. *Mitchell,* 271 U. S. 9, 14; *Sinclair* v. *U. S.*, 279 U. S. 749, 767.

interpolated Item 9a, among the company's *other Liabilities*, such as those for unpaid salaries, bills, legal fees, death losses, commissions, dividends and other claims "*not* involving life contingencies" (pp. 39-41, *supra*).

The items material to the case were as follows:

Item.	
"8. Net Reserve (Paid-for-basis)	$625,747,810".
"9a. Present value of future premiums waived on account of total and permanent disability	$16,629".

The Superintendent of Insurance of New York did not "require", nor even treat, the $16,629 Disabled Life Reserve as any part of New York Life's "Net Reserve"; but, on the contrary, he "*required*" it to be reported among the *unpaid* bills, taxes, salaries and other *accrued* items *not* involving life contingencies (pp. 39-41, 78, 80, *supra*). Therefore, this Court properly rejected New York Life's $16,629 deduction, because,

(*a*) The Agreed Statement of Facts *failed to show* that the $16,629 was the mathematically calculated measure of New York Life's liability for *future, unaccrued* and *contingent* obligations to pay Disability Benefits under its "Disability" contracts; and

(*b*) The Agreed Statement of Facts not only (i) *failed to show* any *law* that *required* the $16,629 as a reserve, but (ii) it affirmatively *showed* that the Superintendent of Insurance of New York *required* this item to be reported as an ordinary *liability*, and *not* as a part of the "Net Reserve", *i. e. not* as a *reserve* "required by law".

This Court said (p. 118):

> "The Circuit Court of Appeals held the deduction should have been allowed, but we think otherwise.
>
> The Superintendent of Insurance of New York *required* this item to be reported as a *liability* and did not treat it as part of the general reserve. Upon the agreed facts *we cannot say* that it was part of any

> reserve required by the laws of New York. There is nothing to show *how* "the value of the contractual benefits" under these policies was arrived at and, *considering the evidence presented, we must accept* the Superintendent's conclusion. The Company *has not shown enough* to establish its right to the exemption."

This Court's decision could not possibly have been otherwise upon the facts revealed in the Record; but it is very significant that this Court apparently recognized that, logically, the $16,629 Disabled Life Reserves *were perhaps,* in a proper case, deductible; because, it so carefully limited its decision by the cautious expressions: "we cannot say", "there is nothing to show", "considering the evidence presented", "we must accept" and the New York Life "has not shown enough" etc., etc.

While a small part of the same kind of Reserve was involved in both cases, [*i. e.* Reserve for Waiver of Premium only] **the facts in the New York Life case were entirely different from the uncontradicted facts established**; because

(*a*) Oregon Mutual *did demonstrate how* its $250,861.09 Reserve for Disability Benefits [$111,127.58 Active Lives and $139,733.51 Disabled Lives] was the *mathematically calculated measure* of Oregon Mutual's liability for its *future, unaccrued* and *contingent* obligations to pay Disability Benefits (R67-112, pp. 14, 41-42, 43-48, *supra*);

(*b*) The B. T. A. and C. C. A. expressly found, and the Commissioner conceded, that the law of Oregon *"required"* this $250,861.09 as the mathematically calculated Disability Reserve (R47; pp. 13, 38-39, 50, *supra*).

The foregoing analysis shows that this Court's disallowance of New York Life's $16,629 "Disabled Life Reserve" is absolutely no precedent here for disallowing Oregon Mutual's Disability $250,861.09 "Reserve" because of the totally different facts shown in the two cases.

CONCLUSION.

In No. 2 the Court of Claims' judgment should be reversed.

In No. 564, the C. C. A. (9th) judgment should be affirmed.

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November 13, 1940.